



International Liability: A change in cadence

Introduction

Notwithstanding the development of various competing factors impacting the International Liability market over the past twelve months, rate increases continue to prevail, albeit on a more moderated scale. This inflection point follows a multi-year cycle of hard market conditions, most likely sustained beyond its natural lifespan by a series of macroeconomic and geopolitical factors.

However, despite the continuing upward pressure on rates, the cadence of the market is notably different to before, as the more balanced negotiating environment can no longer be accurately summarised as a 'hard market'. Following several rounds of compound rate increases, the push — and proffered justification — from insurers for 'remedial' pricing corrections is no longer as pertinent as it once was, which in turn is enabling policyholders to differentiate themselves more effectively from their peers in their quest for the most favourable policy terms and conditions. This reduced momentum to push up rates is coupled with a general drive from insurers to write more premium which has served, at least in part, to reset the equilibrium of the market.

Multiple forces at play

While the change in cadence can in part be attributed to the drive for more business from insurers, a "cocktail" of numerous macroeconomic and geopolitical factors has created a complex and multi-dimensional underwriting environment for the market to operate within.

Rates

The base of the "cocktail" is a continued focus on rate adequacy, albeit on a less intense scale, due to prior poor underwriting results. This is often more pronounced for Excess of Loss layers, as these layers have historically been perceived by underwriters as requiring more rating remediation than the often more technically priced Primary layers, particularly when they are now required to meet new minimum pricing levels. As a result, Excess layers can often be subjected to a larger percentage increase than their primary counterparts.

Growing focus on ESG

As expected, ESG continues to be a factor that influences both risk selection and policy terms and conditions, underlining the importance for policyholders to differentiate their risks from others. To this end, insurer policies on ESG have become even more embedded within the underwriting process, with some insurers even retaining in-house ESG experts to assess policyholders' ESG credentials in advance of placement negotiations. Where buyers do not meet minimum ESG requirements there have been instances of insurance capacity being withdrawn by insurers.

There is also a growing focus from insurers on a buyer's adherence to the Global Industry Standard on Tailings Management which, while separate to general ESG requirements, can be interlinked in the form of local community engagement, land reclamation and water and waste management.

While some buyers, such as those with thermal coal exposures, will have less scope for overcoming ESG hurdles than others, it is evident that all insurers are motivated to look more favourably upon clients that are armed with strong ESG credentials and a compelling climate transition plan. Furthermore, while ESG requirements often exist in the form of thresholds, they are not always applied in the binary manner that one might expect, as demonstrated by the consideration that some insurers are willing to lend to the unavoidable delays in the delivery of ESG milestones experienced by some policyholders because of the conflict in Ukraine.

Notwithstanding this, insurer-imposed thresholds on ESG related exposures, such as thermal coal production, are generally becoming increasingly difficult to circumvent, leaving buyers with less room to manoeuvre in this domain during the placement process.

Russia-Ukraine conflict

The effects of the Russia-Ukraine conflict adds a further layer to the mix, given its impact on underwriters' premium income. A significant amount of premium exited the London market as a result of the sanctions and regulations that were imposed following the commencement of the conflict, meaning that underwriters are now redirecting their focus, both geographically and in terms of target sectors, when searching for more business. Ultimately, underwriters are increasingly more open to risks in (unsanctioned) regions of the world where they may have previously held less of an interest; the mining sector, with its not insignificant premium levels, is seen as a place for insurers to reclaim some of the dollars lost due to the Russian sanctions fallout.

Inflation

An additional ingredient to the "cocktail" of market dynamics is the impact that inflation is having on insurers' approach to pricing, both in the form of economic inflation and social inflation.

In the case of economic inflation, underwriters are having to incorporate increased costs across all key elements of Liability risk into their underwriting models, including but not limited to bodily injury awards, property damage rebuild costs and pollution clean-ups. In the case of pollution, increasing hourly rates of technical and remediation specialists are driving up claims pay-outs, and the same logic can be applied to legal fees associated with Third Party Liability claims more generally.

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The impact of economic inflation on the Liability market is compounded further by the effects of social inflation, including the significant increase in both litigation and average jury award costs as well as broader definitions of liability. While this is more pertinent in the United States than the rest of the world, the impacts can be felt worldwide.

In terms of the impact on pricing, while inflationary-factored pricing can vary depending on the attachment point, insurers are generally looking to apply a base inflation loading to their renewals of +7% to +7.5%, separate to any exposure base change calculation.

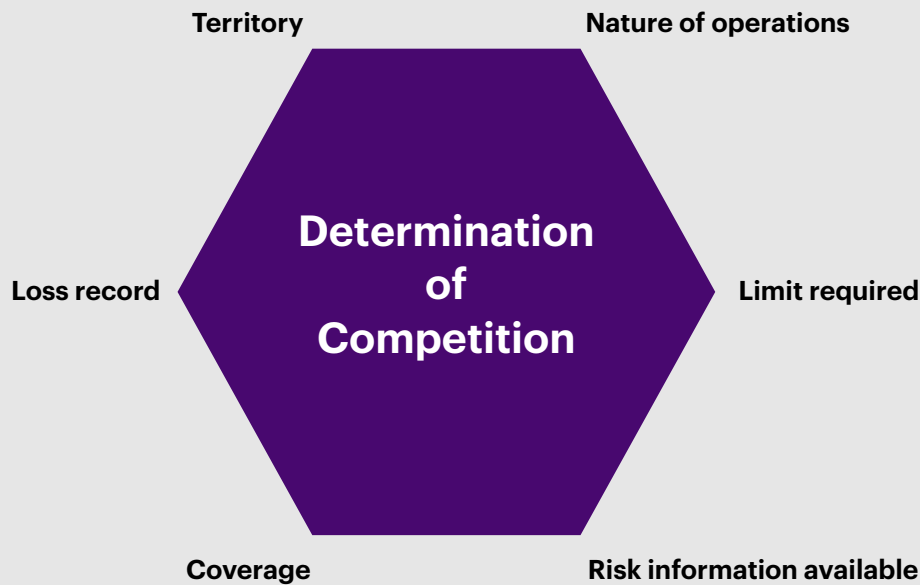
Reinsurance treaty renewals

The garnish on the top of the "cocktail" is the pressure that the recent (i.e. January 1 2023) treaty renewals have applied on rates. While Liability treaty renewals appear to not have been as onerous as Property treaty renewals, single digit to lower double digit increases were the norm for Liability treaty renewals that were not particularly loss impacted. That being said, the average would likely have been even higher if insurers had not sought to mitigate increases by electing to retain more risk themselves as part of the treaty terms and conditions.

Nonetheless, the increases experienced, and their impact on direct market rates, are most likely to be lower than what some feared as we entered 2023. This will in part be due to the conflation of rising treaty costs with inflation generally and in part be a result of the drive from insurers to write more business (reinforced further by the fact that not all Liability reinsurance treaties will have renewed at the start of the year).



Figure 1: Determination of competition in the Mining Liability market



Source: WTW

Factors that determine competition

Similarly to how the moderation of the Mining Liability market is underpinned by various exogenous factors, the underwriting approach to mining risks is also the product of various influences, which in turn determine the level of competition and, ultimately, the capacity and coverage available for policyholders. This is illustrated by the hexagon of factors schematic in Figure 1 above.

Understanding this — albeit rather simplistic — hexagon of factors is important, because the composition of a policyholder's hexagon risk profile can have a significant impact on whether renewal terms and pricing are likely to fall within, or outside of, general market expectations. The lack of competition present during the recent hard market cycle (caused largely by a combination of contracted capacity and an unforgiving focus on rate adequacy) is a key reason behind the significant premium increases experienced by many policyholders during the past few years. However, as we have seen in the market more recently, where programme limits can be placed multiple times over, the existence of competition in the form of alternative capacity leads to downwards pressure on rating levels and protects insurance buyers against the threat of opportunistic pricing.

Territory

Of the factors that form part of the hexagon, 'Territory' continues to have a significant part to play in determining competition. Certain parts of the world such as Latin America, and in particular Brazil, remain subject to reduced underwriting appetite and stricter terms and conditions. Additionally, primary layers for mining risks located in certain areas of Australia, such as Queensland, are being subjected to larger premium increases than mining risks located elsewhere. This is due to the significant spike in mental anguish claims

in the Australian state, resulting from the more liberal judgments from senior judges that apply a broader interpretation of the concept of proximity for claimants, i.e. where previous claimants would have had to have been at least a witness, claimants not even on site at the time of an incident are achieving success in court.

Nature of operations

The nature of the policyholder's operations is of course another key determining factor, as market appetite fluctuates across varying tailings dams' exposures (in particular where upstream tailings dams are present) as well as open-cast versus underground mining operations, the type of minerals being mined and any other ancillary activities such as offshore or transportation exposures.

Limit required

With regards to programme limits, fundamental rules of supply and demand play a part in determining the amount of competition available for any given risk. Quite simply, where limits are smaller and an abundance of capacity is present, the ability to place the risk multiple times over has a positive impact on pricing, terms and conditions for policyholders. This benefit is becoming increasingly realised by policyholders, as over-subscribed programmes have become more commonplace for smaller to mid-size mining companies that do not purchase limits as high as their larger competitors.

Conversely, where a significant limit results in a scarcity of capacity, the inability to leverage markets and explore alternative options can apply considerable upward pressure on rating levels and remove the ability for policyholders to negotiate for and against the application of certain coverage extensions and exclusions.



Risk information available

The quality and availability of risk information can also be a decisive factor in how much capacity — and therefore competition — is present, particularly where tailings dam exposures form part of the risk. The evolution of certain basic minimum requirements when it comes to underwriting information has become a market standard that is set to stay, as the Mining Liability market continues to adopt an engineering-led approach to writing risks that places a significant emphasis on independent tailings dam survey reports in determining the quality of any given risk and its exposure profile (such as types of dams and seismic vulnerability).

These reports (Dam Safety Inspection and/or Dam Safety Review reports) are required per tailings dam facility, as are specific details about their construction and other characteristics such as conformity to global tailings and design standards, frequency of inspections and, critically, details of any outstanding maintenance at these facilities. Where this information is unavailable, underwriters operate under pressure from management to walk away from the risk.

Coverage

Recent renewal cycles have seen terms and conditions being restricted as underwriters were able to rely on hard market conditions to limit their portfolio exposures. While this has not yet been totally reversed, the moderation of the hard market cycle has enabled certain coverage extensions to be obtainable again, as and when a valid case can be made around the specifics of a given risk exposure, its risk management and/or its mitigation.

However, the requirement of broad, non-standard coverage extensions can still have a discernible effect on the number of insurers interested in participating on a programme, as can the requirement for certain conditions to be present in the policy wording. In recent times this has increasingly included climate change and Perfluoroalkyl and Polyfluoroalkyl Substances (PFAS) exclusions.

While various versions of climate change clauses are in circulation, since the London Market Association (LMA) published its own climate change clause this has tended to be the most commonly applied clause by London insurers. However, it is worth noting that the absence of a climate change clause does not necessarily mean the exposure is covered as, depending on the basis of cover, insurers may point to Sudden & Accidental pollution limitations within policy wordings as excluding any coverage for climate change liability.

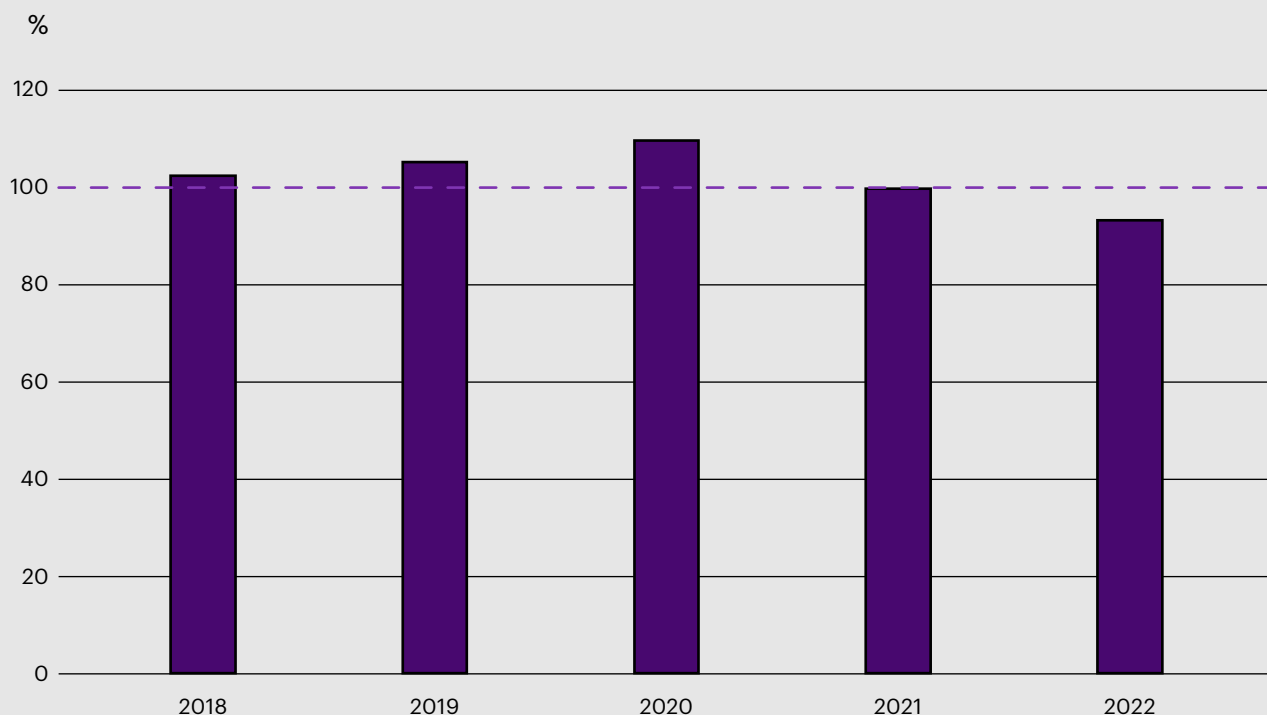
There has also been an increase in the application of PFAS exclusions, which, while not as commonly applied, have become increasingly prevalent, particularly with certain insurers. Notwithstanding this, where sufficient information can be provided there is sometimes scope to limit its application.

Loss record

As may be expected, individual policyholders' loss records provide an important dimension to the overall market appetite available for any given risk. While insurers are keen to increase their premium income, there is an undertone of risk selectiveness that unpins the flight to quality business, meaning buyers in the mining sector with poor quality loss records are likely to continue to struggle to source an abundance of capacity for their insurance programmes.

However, individual loss records are set against a backdrop of a generally improving loss experience for the Liability market. Following multiple years of year-on-year losses, Lloyd's finally reported a return to profit in its 2022 results for Casualty with a Combined Ratio for the class of 93.7%.

Figure 2: Lloyd's Casualty Combined Ratios, 2018-22



Source: <https://www.lloyds.com/about-lloyds/investor-relations/financial-performance/financial-results/full-year-results-2022>
(Page30)

While Lloyd's might point to tighter underwriting controls, several years of compound rate increases and greater risk selection as the key factors behind the improved performance, it is evident that an absence of major tailings disasters (and associated major insurance losses) is a contributing factor to this achievement.

Market capacity and deployment

Capacity nudging upwards

The mining sector continues to be a challenging space for many International Liability insurers, with numerous insurers still abstaining from participating on mining risks. That said, the compound rate increases experienced over the past few years, combined with improved tailings exposure management, has increased the attractiveness of mining as a sector for underwriters, with some insurers who had previously exited the mining sector considering re-entering it. In terms of overall capacity available, this remains relatively stable compared to recent years, although the ability and willingness of insurers currently active in the sector to increase individual capacity deployment is gently nudging the total upwards.

While in theory the total Liability capacity available for mining may be not too far off US\$1 billion, in reality the largest limits purchasable are often significantly lower, as a host of underwriting considerations create a

delta between insurers' maximum theoretical capacity and their realistically deployable capacity. These considerations include, but are not limited to:

- Minimum and/or preferred attachment points
- Appetite for specific aspects of coverage requirements
- Whether the risk is a renewal or new business to the insurer (capacity deployment tends to be higher for renewals)
- The size of the mining company (some markets will only consider participating on programmes of smaller to mid-size mining companies)
- Other underwriting factors pertinent to the individual risk such as location of the risk, extent of coal exposure, construction method of any TSFs and, of course, the loss record

Lead-Follow dynamic continues

Although overall capacity may be nudging upwards, the lead-follow dynamic that emerged in the wake of the Brazilian tailings dams disasters continues to prevail. Whereas some insurers, usually those that have invested in specialist engineering resources — sometimes comprising of former TSF engineers — are keen to adopt lead positions on programmes, other insurers continue to approach mining risks on the basis that they are following a recognised lead that has already undertaken the necessary risk assessment due diligence prior to quoting.

This said, some lead insurers have taken a lighter touch approach to pre-quoting risk engineer assessments in recent months and it could well be that the proliferation of new and evolving capacity in the mining sector softens what was once a very distinct lead-follow dynamic.

Role of captives

A final component of the evolving market dynamics is the role of captives in mining company risk management/insurance programmes. While the majority of policyholders' (insurable) Third Party Liability risk continues to be transferred into the insurance market, the hard market conditions experienced by buyers in the mining sector over the past few years have forced policyholders to consider captive deployment more seriously as a risk transfer strategy, particularly where buyers were left with gaps in their insurance programme "towers" that could not otherwise be filled.

This option is more typically exercised by the larger mining companies with the funds and corporate infrastructure required to set up and meet capitalisation requirements to operate captives. However, it is possible that if buyers continue to be subjected to rate increases, particularly where programmes are loss-free, we may see an increasing deployment of captive participation on programmes taking on portions of risk that may never return to the insurance market.

Conclusion: a new equilibrium

In summary, while rate increases continue to moderate as underwriters push to write more business and capacity in the mining sector gently nudges upwards, there is more to the (very welcomed) change in market cadence than meets the eye.

Underlying the palpable step-change is a multitude of market dynamics, fuelled by a range of exogenous factors that are pushing and pulling the market in various directions to create a new equilibrium. The good news for insurance buyers is that this new equilibrium should be more favourable to buyers, given its predisposition for not only a more balanced negotiating table but also scope for well risk-managed mining companies to positively distinguish themselves from their peers.

With regards to what policyholders might expect in terms of the trajectory of rates, the "cocktail" of market dynamics is expected to lead to a continuation of upward pressure on pricing, with most default insurer renewal positions likely to fall within the range of +5% to +10% rating increases — before any adjustment is made for exposure changes or losses and/or attachment points. While further increases may well sit unfavourably with buyers that have already undergone several rounds of compound rate increases, insurers will likely argue that much (if not all) of any rate increases that ensue will be

offset by inflation and rising treaty costs. However, there is a growing acceptance within the insurance market of 'hard market fatigue' among insurance buyers, and an internal appreciation from the underwriting community that much of the remediation work needed to recognise the vertical natural of mining exposures and bring pricing up to technical rating levels should already have taken place.

As challenging and complex market conditions persist, it is therefore paramount that buyers think strategically about their risk placement strategy. This will need to account for several factors, including:

- Engaging as early as possible with their brokers in order to understand any potential capacity or coverage challenges that may occur
- Ensuring that a high-quality underwriting submission comprising of all of the key mining exposure information and reports forms part of the approach to market, so that the policyholder's risk profile can be positively distinguished from other risks
- Incorporating a clear and robust ESG strategy into the underwriting submission, so that the pool of potential market capacity is maximised
- Reviewing their programme design as a means to achieving the optimal programme structure and capitalising upon evolving insurer appetite and available terms and conditions
- Balancing the benefits of alternative (and sometimes more competitively-priced) capacity with long-term insurer relationships in order to smooth out pricing volatility and maximise the value of insured-insurer partnerships

To conclude, for many different reasons the Liability market remains a complex landscape to navigate for mining companies, and insurance buyers keen to capitalise on the best deals would be well advised to ensure they have robust risk placement strategy in place. However, in order to successfully execute on this, insurance buyers will also need to appoint a broker that possesses the technical knowledge, sector experience and market relationships required in order to achieve the best possible results in what continues to be a challenging market.



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