



# Property: Lack of competitive pressures continues to drive hard market conditions

## Introduction: is the normal market cycle stopped in its tracks?

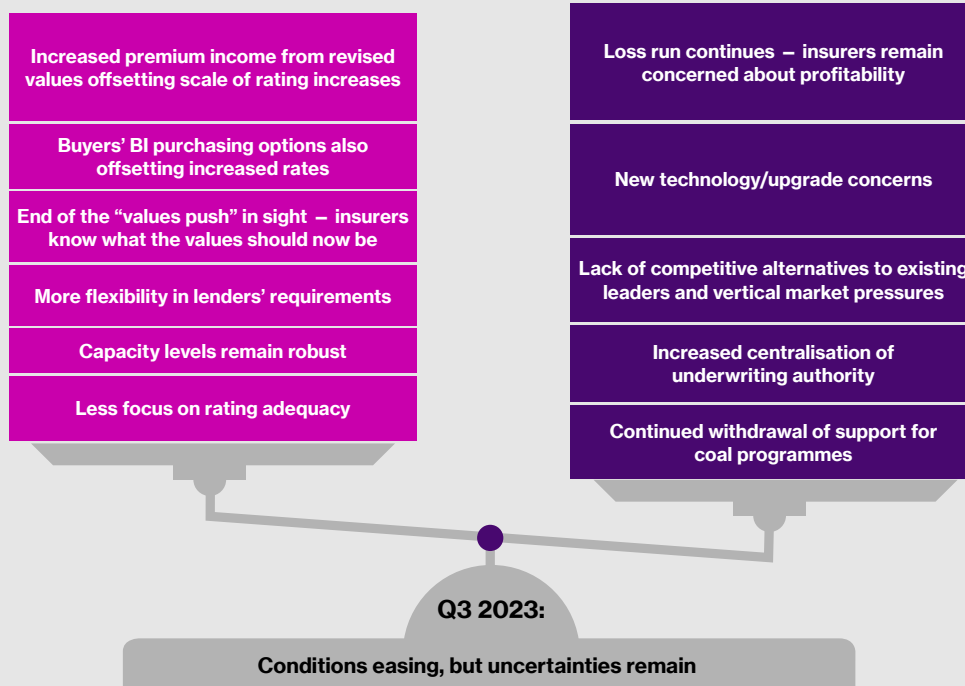
Most readers will be familiar with the concept of the traditional insurance market “cycle”: favourable loss records and extensive competition leads to lower rates and wider, more benign terms and conditions from the insurance market. This then leads to a period of unprofitability, followed by a period of market withdrawals from the sector, leading to reduced capacity and higher pricing; this in turn leads to profitable insurer trading conditions, which then encourages new entrants to the market to provide more competition and rates begin to decline again. Managing this insurance market “cycle” as expediently as possible has been a key risk management driver over the years.

The problem for risk managers in the Power sector is that the traditional Property insurance market cycle seems to have ground to a halt, rather like a fairground cab at the top of a big dipper. For several years now the sector has experienced hardening market conditions; despite this, the prospects for significant fresh competition entering the market to kick start the next phase of the cycle seem to be as remote as ever. Once again this year we have to report rating increases as being the norm in this market, but are there any signs at all that better times are on the horizon for customers?

The Power market has already gone through a phase of hardening and rate correction over the past two years. Towards the end of 2022 there were signs that the Power portfolio was returning to profitability, with flat terms and in some cases actual rate reductions becoming possible. However, deteriorating loss ratios and increased cost-bases (especially reinsurance treaty costs) have put the brakes on any softening; instead, we are seeing a renewed push for rate increases from the market. In particular, insurers’ focus on Nat Cat exposure risks is intensifying, as the frequency and severity of such events around the world and insurers’ own experience continues to deteriorate. For example, Cyclone Gabrielle in New Zealand in February 2023 led to several losses on the New Zealand portfolio, while reinsurance treaty costs have increased significantly, notably again for Nat Cat protection.

There is no doubt that despite the overall gloomy prognosis for customers, there are some positive factors that continue to limit the extent of the hardening market conditions. Let’s take a closer look at both the positive and negative factors affecting this market to determine what customers can expect for the remainder of 2023 and beyond. We have outlined these factors in our “kitchen scales” graphic in Figure 1 overleaf; we will take each of these factors in turn, starting with the positive ones.

Figure 1: The Property insurance market for Power business, Q3 2023



**Continuing hard market conditions still being driven by lack of alternatives to existing leaders and poor treaty renewals**

Source: WTW

## Positive factors

### Increased premium income from revised values offsetting extent of rating increases

As we intimated last year, insurers have had the benefit of a stronger premium flow from the significantly increased values being declared this year. While the conflict in Ukraine and the resulting inflationary pressures around the world have certainly contributed to these increased values, there is no doubt that there has been a marked escalation in them over the last 12 months, with some Business Interruption (BI) values in particular showing as much as a 100% increase — well above average inflation rates. It is also important to note that BI values are more heavily weighted by insurers when calculating rates than the corresponding Property values. Indeed, these have been increasing by a much lower average of 10%, a figure much more in line with global inflation rates.

This dynamic has enabled brokers to negotiate more moderate actual rating increases that in recent years, as the increased premium volume from the revised values has enabled brokers to attract more competition for most programmes than at this stage last year. Moreover, following another poor year for the North American Power portfolio, we are seeing more London market insurers seeking to diversify their books and looking to

write more international business. Historically, Lloyd's Power Syndicates have been heavily weighted towards the US, but more are now expressing an interest to review the International portfolio.

### Buyers' BI purchasing options also offsetting increased rates

Furthermore, customers have often had the option not to purchase Business Interruption on a gross profit basis; instead many have elected simply to buy debt service only or alternatively on the basis of fixed Operating and Maintenance (O&M) costs only. The strategy has also enabled a number of customers to mitigate the effects of the current hard market conditions.

### End of the "values push" in sight

Another good piece of news from a customer perspective is that the end of the prolonged period of insurer insistence on refreshed value calculations is now perhaps in sight — despite the significant increase in values declared over the last 12 months. From our conversations in the market, it seems that the general impression is that the hard work in persuading customers to submit revised value schedules has now been accomplished, and that insurers now have a much better grasp of what the values declared to them should now look like. We therefore believe that the element of uncertainty that has propelled insurers to compensate by

increasing rates still further has now been removed from the equation; although that does not mean that rating levels will start to decline, it does mean that the extent of the increases will now be more moderate. How long this more relaxed state of affairs will last will depend on the extent of any deterioration in the claims record; should the record worsen still further it will prove that this new-found confidence in values accuracy may after all have been misplaced.

### More flexibility in lenders' requirements

For several years now it has been generally acknowledged that it has been impossible for customers to seek to amend the terms and conditions of lender requirements; indeed in many instances these requirements have driven the insurance purchasing strategies of a significant number of power companies. However, we have recently found that for those customers exhibiting positive ESG profiles, lenders are now becoming more flexible in what they are demanding; if a good case can be made for modifying these terms, they are becoming more willing to do so. If either:

- the lender's requirements can be proved to be driving too much cost, in terms of either policy limit and/or deductible requirements; or
- customers require greater flexibility in what they buy so that it dovetails with their risk transfer strategy

Lenders are now responding to the more challenging business environment and agreeing to modify their terms which they would not have agreed to before, on the basis that it makes financial sense.

Brokers are now able to help their customers build a case to reduce their lender requirements, improve deductibles, and potentially reduce limits, which can all contribute to reducing the customers overall premium levels.



### Capacity levels remain robust

One more good piece of news for customers is that in overall terms capacity remains plentiful. Not only have there been no major withdrawals from the Power market in recent years but the existing capacity has also been augmented by a number of MGAs, particularly in the London market, while China's plan to establish a reinsurance centre in Shanghai may eventually increase Chinese market capacity. Such is the cost of setting up a new bona fide underwriting operation (including reinsurance treaty costs) it is not surprising that there have not been more new entrants and that providers of insurance market capital tend to prefer using MGAs to take advantage of today's market conditions. In this way, the parent company can test the market without committing themselves on a permanent basis. In any event, this development is welcome news for customers as if certain insurers have given their authority to someone else to write on their behalf, that shows some confidence in the current market conditions and this in turn, at least in theory, should ease the upward trend in rating levels.

As in 2022, we estimate that overall capacity remains at approximately US\$3.5 billion, with realistically deployable capacity close to the US\$1.5 billion mark. However, in relation to coal assets this amount reduces to a much lower figure of around US\$250 million (coal capacity for new risks entering the London/European markets is significantly lower, and it might pay buyers to differentiate between existing and new business).

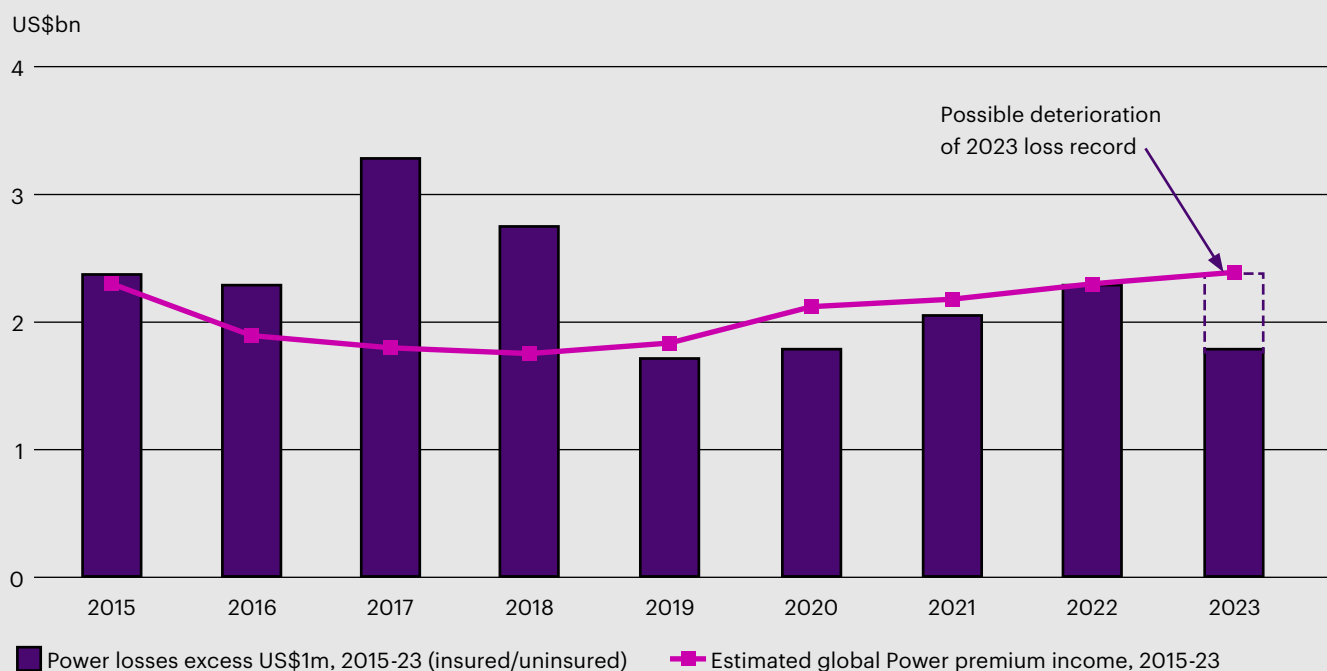
### Less focus on rating adequacy while deductible levels remain low

While as we have seen insurer pressure to declare revised values has eased for the time being, there is now a genuine debate in the market as to whether underwriters have now achieved technical rating adequacy. Obviously there have been some significant corrections in rate over the last few years, but as we will see later the market is still being hit by significant Power claims. That being said, in our conversations with insurers in London we sense that they don't feel they can permanently maintain true technical rating adequacy, because competitive pressures will always kick in before such rating levels can be achieved. As brokers, we are already finding ourselves in a position where programmes are routinely over-placed and expensive capacity can be discarded.

Moreover, deductibles are now generally at the minimum technical levels, and almost never form part of any increased terms from the market. Most have not tracked with inflation and in some cases have remained static for up to 10 years. Insurers are happy to maintain them at their current levels — despite recent inflationary pressures — because these levels yield the maximum amount of premium income. All this remains good news for the customer, unless increased attritional claims activity produces an excess of "dollar swapping" in the future, in which case the current levels may be a focus for insurers next year.



Figure 2: **Estimated Power losses 2015–2022 (excess of US\$1m) versus estimated global Power premium income**



**How many losses below US\$1 million are affecting the portfolio in 2022?**

Source: WTW market intelligence/WTW Energy Loss Database as of July 19, 2023 (figures include both insured and uninsured losses)

**Negative factors**

**Loss run continues as insurers remain concerned about profitability**

Figure 2 above shows WTW’s best estimate of overall global Power losses excess of US\$1 million compared to estimated global Power market premium income. It can immediately be seen that the loss record in this market continues to deteriorate, with the 2022 total now reaching some

US\$2.3 billion (outstripping 2021’s US\$2.1 billion) and with 2023’s figure forecast to eventually reach US\$2.4 billion. In the meantime, while premium income for this class continues to rise, all the indications seem to suggest that total premium levels will only rise to a similar figure (US\$2.4 billion) by the end of 2023. We do

appreciate that these are only estimates and that the final figures for 2023 may vary from these projections; however, what these estimates do suggest is that overall profitability — and indeed technical rating adequacy — may still be beyond the market’s grasp at present.

Figures 3 and 4 on the next page outline the major losses recorded by the market to date for 2022 and 2023. There is no doubt that increased BI values and supply chain issues, particularly in North America and Europe, have had a major impact on the overall loss totals for both years.

Figure 3: **Power losses excess of US\$20 million, 2022**

Plant type	Cause	Region	Total US\$
Gas	Fire/Explosion/VCE	North America	350,000,000
Gas	ST Generator Short	North America	154,000,000
Coal	Fire/Explosion/VCE	North America	130,000,000
Gas	HRT collapse	South Asia	100,000,000
Gas	HRT collapse	Latin America	90,000,000
T&D	Mechanical Breakdown	Europe	60,000,000
Gas	Compressor damage	Middle East	50,000,000
Hydro	Mechanical Breakdown	Europe	50,000,000
Gas	Mechanical Breakdown	Latin America	50,000,000
T&D	Anchor/jacking/trawl	Asia Pacific	45,000,000
Coal	Fire/Explosion/VCE	North America	40,000,000
Gas	Compressor failure	North America	40,000,000
Gas	Mechanical Breakdown	Europe	35,000,000
Gas	Generating trip	North America	30,000,000

Source: WTW market intelligence/WTW Energy Loss Database as of July 17 2023 (figures include both insured and uninsured losses)

Figure 4: **Power losses excess of US\$20 million, 2023 (to date)**

Plant type	Cause	Region	Total US\$
Gas	Crane tower collapse	Middle East	205,000,000
Waste to Energy	Fire/Explosion/VCE	North America	205,000,000
Gas	Mechanical Breakdown	North America	80,000,000
Gas	Electrical generator short	North America	50,000,000
Gas	Mechanical Breakdown	North America	28,000,000
Gas	Transformer failure	Latin America	25,000,000
Gas	Flood	Latin America	25,000,000

Source: WTW market intelligence/WTW Energy Loss Database as of July 17 2023 (figures include both insured and uninsured losses)

What do these premium and loss statistics mean for the customer? In essence, they demonstrate why, despite several years of hardening market conditions, insurers remain reluctant to offer more preferential terms, and why they remain determined to press ahead with rating increases in an effort to demonstrate to their management that this portfolio remains an attractive one.

### New technology/upgrade concerns

In addition to the general concerns that the Power market has regarding its overall profitability, the concerns that we raised in last year's Review regarding the application of new technologies or upgrades. In particular, insurers' focus remains on some specific gas turbines manufactured by well-known OEMs which they believe contribute directly to the current unfavourable loss record. Although some milestones have been reached for some upgrades, with more being reached as this Review went to press during Q4 2023 — which will allow more insurers to underwrite these new technologies than previously — others have found that new concerning issues have recently materialised which has only increased their apprehension in underwriting programmes featuring these technologies.

The deployment of new technologies is an issue that is constantly evolving, with the introduction of new hydrogen burners dual-fuelling and conversions from heavy fuel oil and diesel being good examples. Brokers have responded by using their engineering expertise to demonstrate that these technologies have been sufficiently well managed to ease insurers' concerns regarding LEG 1 issues, so as to prevent the imposition of further coverage restrictions by insurers. One well known OEM, for example, has designed their hydrogen burners to make the flames smaller, which makes them easier to control; however this is generally an expensive avenue for buyers to go down, with only a handful of units worldwide actually deploying these burners. As such, supply chain issues are bound to arise and it must be remembered that to be considered ESG-friendly by insurers, power companies have to produce hydrogen from a clean source.

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**The Power market continues to be beset by a high degree of “vertical” pricing, whereby each insurer offers specific pricing for their particular participation in any given programme.**

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Moreover, while this strategy has had some success with regard to hydrogen burners, market concerns remain as to any changes to blades, or any further changes relating to the development of hot gas path technologies; here there is a significant underwriter concern, such that some companies deploying these technologies may now be in danger of not securing any meaningful insurance capacity at all.

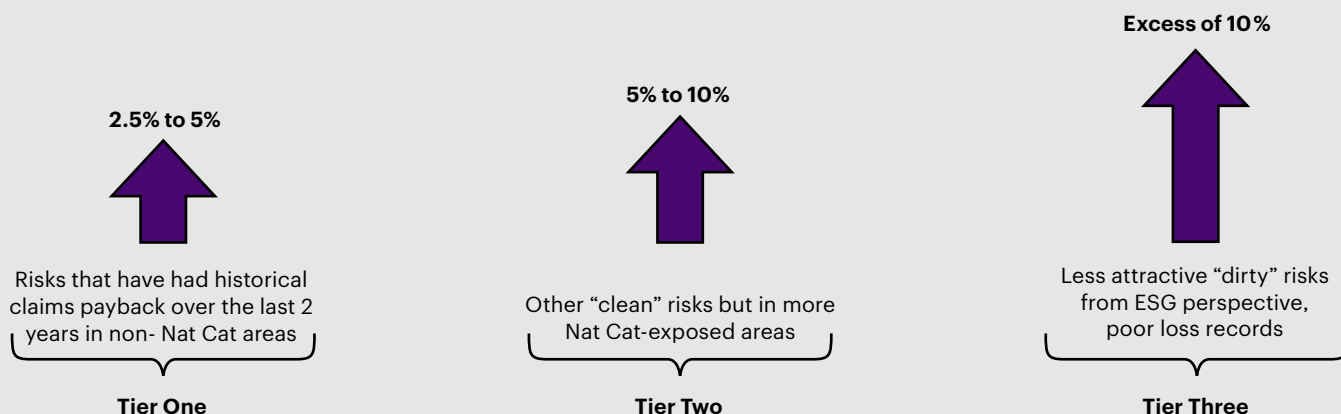
Finally, specialist Power insurers are looking to impose fuel supply quality clauses, making sure the operators of the plant in question are running it properly. We are also seeing a number of new gas-fuelled power plant projects becoming operational in recent years; this development maybe as a reaction to the increase in renewable power, and the potential instability that this might create in economies across the globe.

### Lack of competitive alternatives to existing leaders and vertical marketing issues

Another besetting reason for the continuation of the hard market conditions remains the lack of competitive alternatives to existing leaders, as well as the continuing vertical marketing issues throughout the market. With the barriers to entry still relatively high, and with the profitability of the Power portfolio by no means demonstrable in general terms, it is perhaps unsurprising that not only has there been no significant new entrants to this market (other than MGAs as mentioned earlier) but also that none of the existing market has come forward to indicate that they are now prepared to act as leaders to challenge the existing panel. As a result, although the current market leadership panel has generally adopted more moderate stances over the course of the last 12 months, brokers are still finding it challenging to generate competitive alternative marketing strategies involving fresh underwriting thinking.

Moreover, the Power market continues to be beset by a high degree of “vertical” pricing, whereby each insurer offers specific pricing for their particular participation in any given programme. This means that simply obtaining lead market terms from the existing panel will by no means be the end of the marketing process for the broker; indeed, a significant number of following insurers are now demonstrating firmer underwriting stances than the leaders. So even where leaders are rewarding customers with more generous terms where appropriate, their efforts to reward these companies can often be thwarted by following insurers insisting on maintaining their own harsher underwriting stances. And although we have seen more interest from some followers to participate in the most sought-after programmes, no following market is currently in a position where they are generally obliged to accept most of the business that is offered to them; in most cases that they can hold out for their own individual terms.

Figure 5: **The three- tier market maintained– average rating increase in the Power Property market, Q3 2023**



**The Power market continues to experience rating increases almost across the entire portfolio, despite buoyant capacity levels – there is just no challenge to the prevailing market leaders**

Source: WTW market intelligence/WTW Energy Loss Database as of July 19, 2023 (figures include both insured and uninsured losses)

#### Increased centralisation of underwriting authority

One reason for this new found confidence from the following market has been the increasing centralisation of underwriting towards the London market. Whereas in more benign market conditions we have witnessed the expansion of underwriting hubs around the world, in recent months we have seen underwriting authority at several hubs withdrawn, with decision-making returning to London. This has increased the premium flow to London, which may well have served to increase London market income but has also had the effect of blunting global competitive pressures.

#### Continued withdrawal of support for coal programmes

A final negative factor impacting power industry customers is the continuing lack of insurance capacity for coal-fired power plants, an issue which has become more pertinent in Europe as countries have sought short term alternatives to secure energy supply following the continued conflict in Ukraine. As some previously mothballed plants become reactivated, owners are effectively being given a choice between self-insurance and governments acting as insurers of last resort in order to effect any kind of risk transfer for these assets.

#### Conclusion – today’s Power market rating environment

Figure 5 above indicates the average percentage rating increases that are now being negotiated in today’s Power insurance market. Readers will notice that very little has changed since our 2022 Review; for example, the best programmes are now showing a +2.5% to +5% rating increase, compared to flat to +5% increase advised last year. This simply indicates that, for now, the negative factors described earlier as just about balancing the positive ones as the hardening dynamic starts to falter a little.

What can customers expect from the rest of the year? Whether or not the hardening dynamic will accelerate again will depend very much on the development of the current 2023 loss record. Should further major losses materialise, customers can expect rates to increase still further; however if the anticipated loss levels depicted in Figure 2 don't materialise, brokers may be provided with the leverage they need to force a halt to the current hardening dynamic.

As ever, forward planning is essential if customers are to mitigate the worst effects of the current market conditions. Those that engage with their brokers early to develop an effective marketing strategy will be best placed to drive improvements to their current terms — or at least limit the rating upswing to the barest minimum.



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