International liability: The end of the hard market?

Our 2024 Review contains a certain canine and zoological theme, as we seek to analyze the current status of the energy liability market. As always, it is helpful to first consider the key drivers for market conditions. These are, most particularly, treaty renewal costs, market profitability and available capacity.

2024 treaty renewals: A shaggy dog story?

There was significant doom-saying prior to the 1 January 2024 liability treaty renewal season, with a number of treaty reinsurers talking-up the market.

Much stemmed from the same very valid concerns facing direct insurers, namely social inflation; adequacy of reserving and the ever-increasing claims stemming from the U.S., most particularly in respect of U.S. auto and workers, comp.

One particularly interesting feature was the emergence of U.S. claims from books of ostensibly international treaty business. A case in point being the successful class action claim relating to the collapse of a condominium in Miami in June 2021 for which the international security company responsible for alleged negligence of the guard, was found liable for almost half of the $1 billion claim. This has prompted many reinsurers to analyze their books more closely. In particular, one reinsurer, who was hit three ways on this loss (via their direct, facultative and treaty participations) has cut back its overall maximum direct liability line size as a result.

Despite worst fears, treaty negotiations were conducted in an orderly fashion with adequate capacity and no major changes to conditions or retention levels. Pricing was on average higher than for the property treaty renewals, with risk-adjusted rate increases for liability treaties being in the mid-single digit range.

Market profitability: The patient is recovering well...

The Lloyd's of London financial results are a good barometer of the overall health of the various lines of Insurance business, more broadly. In our 2023 energy market review update we noted that for the first time in eight years, casualty as a class finally returned to an underwriting profit.

Figure 1:

Lloyd's annual results for the casualty sector:

Year	Gross written premium £M	Combined ratio %	Underwriting result £M
2014	4,959	98.1	74
2015	5,764	100.1	(5)
2016	7,131	102.7	(146)
2017	8,464	103.1	(189)
2018	9,094	102.9	(183)
2019	9,459	105.7	(390)
2020	9,067	110.3	(688)
2021	10,360	100.3	(17)
2022	12,987	93.7	536

Source: Lloyd's Annual Report 2022

This trend has continued, with positive H1 2023 casualty results reported by Lloyd's in September 2023:

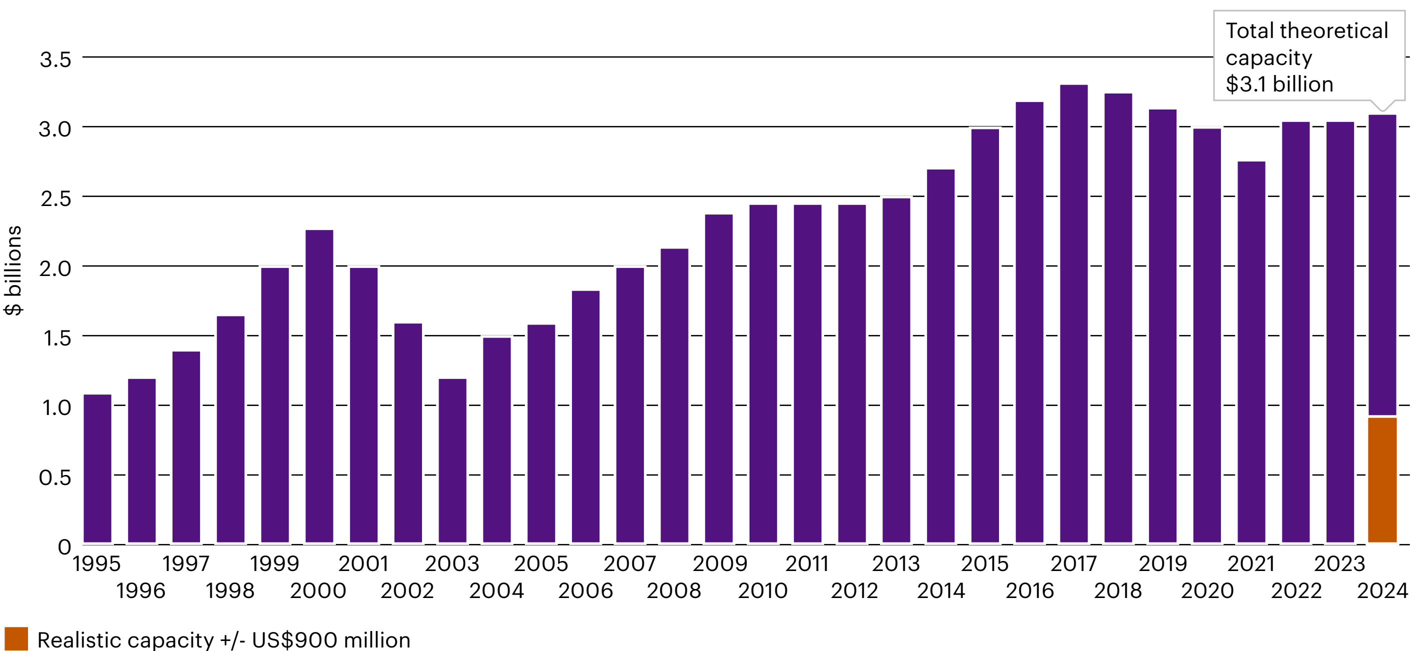
Year	Gross written premium £M	Underwriting result £M
H1 22	6,030	425
H1 23	6,530	404

Source: Lloyd's Half Year Results 2023

Whilst Lloyd's definition of casualty includes directors and officers, financial lines, cyber and accident and health as well as liability, it nevertheless reflects the general recent trend of improved profitability within the liability sector alongside other lines within the class. This positive news on profitability should however be caveated with recent concerns regarding reserving adequacy, which we consider below.

Figure 2:

Global liability capacity



Source: WTW

Market capacity: Hidden undercurrents of change

Total headline global liability capacity shows a modest uptick in 2024 from $3.05 billion to $3.1 billion. Likewise, we estimate that realistic capacity has increased from $850 million to $900 million. These small changes, however, hide greater underlying changes, with opposing dynamics at play.

On one hand, we have seen a recent reduction in maximum line size by some of the major insurers, for one of two reasons: treaty renewal costs and maximum exposure concerns. Certain insurers with higher than anticipated treaty renewal costs in 2023 elected to buy less. Other major insurers, particularly those hit by unexpected U.S. losses to their international book (as in the case described above) have chosen to cut back their overall participations per risk. As a result, approximately $80 million of existing capacity has been lost from the market.

On the plus side, some insurers have expanded their line sizes (particularly more recent entrants, having built up a satisfactory premium reserve pool) and others, most notably TMK HCC, Sompo and Probitas have expanded positively into the energy liability sector.

Whilst the net result appears as a minimal uptick in capacity, the reality is an increase in insurer choice and greater competition, which is positive news for buyers.

Reserving concerns: Tail bites dog?

In newspaper parlance, 'dog bites man' is not a story, but 'man bites dog,' most certainly is. In the liability world, the headline narrative is the concern that the 'casualty canine' may be bitten hard by its tail.

Economic inflation has been a common factor across most lines of business, with raw material shortages, increased rebuild costs and wage inflation driving up the cost of claims.

The liability sector faces the additional challenge of social inflation with the increasing propensity to claim, fuelled further by social media and third-party litigation funding, combined with higher court awards, 'Thermonuclear' verdicts in the U.S., and the erosion of tort reform to favour plaintiffs, all having a significant impact on the frequency and quantum of liability claims.

According to Advisen loss data, the median cost of awards over $10 million increased by 35% from 2015 to 2020, rising from $20 million to $27 million and this trend continues.[1]

There is a view that loss reserving for the liability sector in general has been insufficient over the past decade, most particularly for the period from 2016 onwards. Many insurers have been increasing their reserving as a result. One of the strongest voices of concern has been Swiss Re, who announced in its February 2024 Annual Results that it will strengthen in its casualty reserves by over $2 billion. This is on top of the $6.1 billion of casualty reserving since 2015. Other insurers are following suit. However, concerns remain that if the tail deteriorates, including the last four years which, despite pricing corrections, may be less benign that hoped, then insurers may be forced into a re-evaluation of the current moderating price levels.

Clearly this is a macro level view of liability sector profitability, but it informs and directly influences the liability energy sector. In energy-industry-specific terms, whilst there has been an absence of major energy cat liability losses, pollution losses remain a concern, particularly in the midstream/pipeline sector where there have been a series of small to mid-size pipeline pollution claims of $10 million to $25 million in magnitude which have directly impacted the net retentions of many primary energy insurers.

Auto liability remains a source of claims concern, particularly for international clients with U.S. exposures, as do wildfire losses from a potential cat perspective.

The Peruvian terminal operations oil spill pollution event in 2022 is a topical example of the issue of claims inflation and reserving adequacy. Previously reserved at $350 million, most insurers have increased reserves to $600 million+ and face the prospect of class action, filed in the Hague in January for $1 billion. This would seem to underline the continuing concerns many insurers have regarding the validity and sufficiency of current reserving levels, more broadly.

Fac tap: Flow reduces

Whilst market capacity remains relatively abundant, a subtler trend to watch is the diminishing appetite of the facultative reinsurance market for energy liability business. Facultative reinsurers, wary of the increasing ESG issues on the horizon for many energy insurers, have chosen to trim their capacity, become much more selective and focus more on other industry sectors.

Push-pull of conflicting forces

Those readers of a certain age may recall a famous fictional character named Dr Dolittle who, during his travels, encountered a strange animal with two heads at opposite ends of its body, called the Pushmi-Pullyu. This rare beast illustrates well the conflicting dynamics in the current energy liability market. On one hand, the positive factors of increased capacity, greater competition, positive recent results, broker pressure and a desire for income growth are pushing towards a softening of the market, or at least, a moderation in the level of previous rate increases. On the other hand, concerns about social inflation, reserving adequacy and treaty cost increases and facultative capacity reductions are acting as a slight break.

The net result is that the liability pushmi-pullyu is edging slightly nearer to a softer market but has not quite arrived there yet. So, what does this actually mean for buyers, in renewal pricing terms?

Pricing: It's all relative

Over the past 12 months, renewal price increases have moderated from, on average, mid-to-high single digit in 2023, to mid-to-low single digit increases in 2024, with average base price negotiation starting points having reduced from +7.5% to +5%.

We have however noticed an increased level of volatility and insistency, with significant fluctuations around the norm. Clearly, increases or reductions in material exposures will affect the average rate as will the nature of an insured's activities.

Clients with greater midstream exposures, oilfield service operators and wildfire-exposed risks are favoured less that those with benign, less loss-exposed industry profiles. Equally, international accounts with U.S. exposures are treated much more cautiously, as insurers grow increasingly concerned about the growth in quantum and frequency of U.S. originated claims.

Insurers are also increasingly focused on rate relativity rather than default rate change requirements.
Those accounts that are considered adequately rated by insurers will receive more favourable treatment than those that are still viewed as underpriced.

[1] In The Know: Social Inflation and the Increasing Cost of Large Jury Awards: VMG Insurance per Advisen Casualty Loss Data
https://www.vgminsurance.com/handlers/secure-document-handler.php?file=6df54e5133b55d0c152da603804232a8.pdf

There are also sector-within-sector differences. From a broader natural resources perspective, renewal changes for mining accounts or energy clients with significant mining exposures are seeing minimal rate change, as this sector has already had significant rate increases factored in over the previous five years.

New accounts and those with small limits are achieving the most favourable terms as insurers fight for market share. Insureds requiring significant limits are benefitting from some rate moderation and experiencing, on average, mid-single digit increases. They are, however, no longer held to ransom for the final capacity on larger progams and are able to fill gaps or push back up limits, using the new and/or increased capacity.

Climate of change: Coverage considerations

The most common coverage issues continue to be the increasingly widespread imposition of exclusions relating to PFAS (Per-and polyfluoroalkyl substances) and climate change liability. Whilst PFAS exclusions are increasingly broad blanket, buyers that can articulate their exposures have the most success in limiting any exclusions to fire retardant activities. Climate liability exclusions are also becoming increasingly commonly imposed. This is illustrated by the most recent JL London Umbrella form JL2022-016, which amongst other changes, includes exclusions in respect of both PFAS and climate change.

ESG and energy security: Devil or the deep blue sea?

Environmental, social and governance considerations remain very much on the radar with clients and brokers carefully tracking the market appetite for energy business.

There is certainly an increased focus and selectivity by insurers as to how they deploy their capacity. Coal — fracking — and Arctic drilling-exposed insureds have already experienced serious capacity constriction and some carriers have exited the hydrocarbon sector completely. Many insurers are, however, seeking a greater degree of self-governance, in order to have discretion to positively discriminate and support coal or hydrocarbon risks with a credible transition plan and/or a strong renewable energy mix. This was illustrated by the withdrawal of Lloyd's and many insurers from the Net Zero Insurance Alliance in 2023.

Some insurers have suggested that the recent moderation in energy market pricing conditions could be short lived followed by an 'ESG' related rate-bounce as future capacity exits the energy liability sector, driving back up pricing. We are yet to see any immediate signs of this materialising and the increased focus upon energy security remains as a counter pressure to less-nuanced environmental concerns.

Conclusion

In summary, it is good news for buyers. Capacity, although only up slightly, includes a greater variety of participants, increasing competition and choice. Rate increases are currently still the norm, but moderated from 2023, with an anticipation that further moderation may continue throughout 2024 — provided that back year reserving clouds do not rain on the parade. Could 2024 see a final end to the dog days of the previous hard market? It is certainly directionally heading that way, though differences remain by sub-class and by territory with international and North American exposures in particular continuing to have differing dynamics.

Whatever the weather, whatever the change, one certainty remains: insurers continue to favour buyers with strong market relationships, a compelling carbon transition plan and a well-articulated risk management strategy.

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