Lowenstein Sandler's Insurance Recovery Podcast: Don’t Take No For An Answer

Episode 77 -
Policyholders Beware: Maximizing Commercial Property & Casualty Insurance in a Steadily Hardening Market

By Eric Jesse, Heather Weaver, Brad Barron, Josh Weisberg

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Eric Jesse: Welcome to Don't Take No For an Answer. I'm Eric Jesse, partner in Lowenstein Sandler's Insurance Recovery Group, and today, I'm pleased to be joined by my colleague, Heather Weaver, who's counsel on Lowenstein Sandler's Insurance Recovery Group. So together, Heather and I like to fight the good fight on behalf of our policy holder clients in claims disputes. So Heather, welcome back to Don't Take No.

Heather Weaver: Thanks, Eric. Great to be here.

Eric Jesse: Great. We're also thrilled to have two guests on our program who know their way around the insurance market, so I'd like to introduce our listeners to Josh Weisberg, who is the Chief Risk Officer at SterlingRisk. Welcome, Josh.

Josh Weisberg: Great to be here, Eric.

Eric Jesse: Great. I'd also like to introduce everyone to Brad Barron, who is partner and managing Deputy General Counsel at Conner Strong & Buckelew, which is also another insurance brokerage firm.

Brad Barron: Thanks, Eric. I know it's a mouthful there with all the names and titles.

Eric Jesse: All good. Hopefully, I got it right. So we're happy to have you both here. So today, for our listeners, we're going to have an interesting discussion about recent developments in the property and casualty insurance market, and our loyal listeners know that we like to keep things practical here on Don't Take No, and like I said, Josh and Brad know their way around this market, and so they're going to share the current state of the market, major drivers, newer coverage restrictions that they're starting to see, and they're going to look into their crystal ball and let us know where they think the market is going over the next few years. With that, let's dive in and I just want to ask a table setting question here. Josh, can you let us know, when we're talking about property and casualty insurance, what are we really talking about? What are the policies and types of coverage at play?

Josh Weisberg: Property and casualty actually covers a broad spectrum of different kinds of insurance products, but principally, when we're talking about P and C in the colloquial sense, what we're talking about is your core property insurance, your commercial property insurance, and on the casualty side, we're really talking about general liability insurance. And there are other forms of insurance that fall under the P and C umbrella, but when we're talking about the property and casualty marketplace, we're really talking about those two core coverages.

Heather Weaver: Thanks, Josh. What type of risks do those property and casualty policies cover?

Josh Weisberg: So on the property side, you're looking at obviously your buildings. If you are a real estate owner and you have a commercial real estate building, you're talking about the physical structure, you're talking about your business personal property that you have, your inventory that you have inside that building. You're also talking about potentially your lost income in the event of a claim, so for example, if there's a fire and you can't draw revenue from that building, your loss of business income, that's going to be covered under your commercial property policy. On the liability side, if somebody slips and falls on the sidewalk outside your building and they decide to file a claim against your building, your insurance is going to protect you against that kind of claim. So you're going to have your general liability policy and then your excess liability policies over and above that will give you coverage for that kind of loss.

Heather Weaver: Great. Now that we've gone over what property and casualty insurance coverage is, Brad, can you tell us a little bit about what is going on in the property and casualty insurance market that policy holders should be aware of?

Brad Barron: If you look back over the last few years, the combined ratio, which is the indication of are insurance companies profitable or not based on the premium they're taking in versus the losses and overhead that are going out the door, that combined ratio has them in the red, so they're paying more expenses and losses than they've been taking in premium for the past few years. Putting aside investments and where they're getting income from that, you see carriers trying to scramble to get back in the black. They want to be profitable just based off of underwriting, and so that's really driving I think some of the pressure here. I think another thing is if you look back historically, maybe 10 years or so, you're looking at almost a 50% decrease in the losses that are being paid out.

So if you go back to 2013, you're at about a hundred, 110 billion of losses paid out in the P and C market, and today, last year, I think we're at something like 210 billion, so almost doubling in just 10 years. It's 7% ish compound growth every year in terms of the amount of money that's going up.

Eric Jesse: So what's driving that doubling?

Brad Barron: I think there's all sorts of theories. I am sure Josh has some as well. I think number one, the carriers will tell you, plaintiff's bar, right? On cases that are disputed, those cases are settling for much higher amounts than they would've been a few years ago. That's being driven by juries as well as just carriers not wanting to fight battles with bad facts. I think you're also seeing issues, at least more recently, with supply chain. So like Josh said, when you have a fire and your business isn't able to operate, five years ago, you probably could have gotten the raw materials let's say in a month or two to start building. Now, you hear people are waiting 4, 5, 6 months just to get the raw materials, so that's just a longer time period that you have loss of operating capacity, so your losses are going to go up.

And we hear a lot about social inflation, the other driving aspect, which is I think people generally today value especially liability claims where someone is at fault for someone else's injury at a much higher amount than they would have even 5, 6, 7 years ago.

Josh Weisberg: So there's social inflation and there's inflation, and that's another major driver of premium increases, really has to do with actual inflation within the marketplace. So using Brad's example, if you've got a fire and it used to cost you $50 to rebuild that building after the fire, raw materials just cost more. And some of that has to do with supply chain, but a lot of that also has to do with higher interest rates and sourcing materials and how expensive it is now in comparison, again using Brad's example, to 2013, it's enormously more expensive now to rebuild a building. And when an insurance company sells you a commercial property policy, what they're essentially contracting with you to do is if there is a fire and you have to replace that building or you have to rebuild it, we're going to pay the cost associated with affecting that rebuild, with completing that rebuild. And if it used to cost only $5 and now it costs $50, it's going to cost the insurance company more, which means that's translating into increased premium. So that's another important inflationary aspect that's driving price in the marketplace for insurance.

Heather Weaver: Do you think that some of the supply chain issues and the inflation issues are still a result of COVID-19? And have you seen those issues continue to be as problematic as they were right after the pandemic hit in 2020? Or do you see it headed into a better direction that would be more favorable and fewer supply chain issues?

Josh Weisberg: I'd say that you're still seeing tailing indicators of supply chain disruption related to COVID-19, but what's so interesting about supply chain is it's a very dynamic issue, meaning that whereas COVID-19 was at some point a driver of supply chain disruption, there are other global drivers of the exact same problem. So for example, conflict in Ukraine or any other geopolitical turmoil, that leads to issues in terms of sourcing raw materials. Wildfires in Canada drove up the pricing on lumber. That gets translated again into replacement costs and it drives a premium. So Brad, I don't know if you disagree, but I think COVID-19 is still a legacy driver, but there are all these other factors that get baked into the mix that continue to create supply chain problems.

Brad Barron: I think it's anything that impacts the economy, so you could say just the labor force, where's labor going? I think you see shortages of truck drivers, which means it's harder to get the supplies from A to B. It takes longer for it to happen; it's going to cost more. All of those aspects, it's a huge web that comes together, and I don't know that I'm brave enough to say it's going to go up or down. Just that I think it's still out there and I don't know that it's getting fixed anytime soon in terms of prices are going to at least hold steady or go down.

Josh Weisberg: Totally agree.

Heather Weaver: What about increases in natural disasters, hurricanes, earthquakes, disasters like that? Has that been impacting the property casualty market?

Brad Barron: I would say for sure. I have a couple of pet theories about that as well, but I think when we look at things like hurricanes down in Florida for example, I think one of the things that people tend to forget a little bit is if you look at Florida 50 years ago versus today, you have much more expensive buildings, much closer to the beach, much denser packed. So you have less land that is going to be able to absorb water, storm surge, whatever. You have higher prices, buildings much closer to the potential storm surge, and so you just have a much richer environment for problems and losses in a lot of ways. And so I think that is an aspect when you think about what's driving the losses. When a carrier used to say, "Well, I'll cover the state of Florida." Well now, the state of Florida, for example, has whatever times the value of homes and property it used to have just because there's a lot more people there with a lot more expensive homes in commercial real estate.

It wasn't that long ago, we had Sandy up here on the Jersey shore for those of us who live in the Mid-Atlantic, and you combine that with all these other aspects that are going on, especially you look at wildfires, earthquakes, that stuff, it's no longer impacting a small amount of people. You always hear, "Oh, this estimated value of the losses are X billion." I would be surprised if modeling didn't show that these same hurricanes, if they came through 30 years ago and did the exact same level of damage, would be a lot less just because there's fewer people and fewer buildings around.

Josh Weisberg: I think that that's true. I think that there's a parallel track that this runs on too, which is, and this is just an interesting anecdote, we had in our offices here at Sterling a senior underwriting representative of a major property carrier a few weeks ago, and one of the things that they showed us, to Brad's point about increased values in areas that are targets for catastrophic storms or catastrophic losses, what they actually showed us is that over a 20-year period, just some of the changes in natural weather patterns. And what I basically mean by that is they showed us modeling where the tornado alley that effectively runs from New Orleans all the way up through that area that spreads between the Mississippi River and the East Coast has started to shift. So whereas they used to know that tornadoes ran on a basic general trajectory, it's now moved hundreds of miles to the west, whereas it used to lean closer to the Appalachian Mountains.

And the reason why that's so important is when underwriters or commercial property carriers are looking at what's my risk in one particular geographic location? They're looking at what Brad's talking about, which is, eye to God, substantial buildup in one particular area, substantial buildup in the south of Florida. But now, I have to worry about substantial buildup in other areas that weren't necessarily as exposed to events like tornadoes and windstorms, and it creates a lot of dynamic challenges in underwriting a risk because you have less predictability. So it really is those two things coming together. Definitely increases in the number of catastrophic storms and weather events, but at the same time, you have buildup in areas where we already knew that there was exposure to these kinds of storms, and that drives things up and makes things very difficult to underwrite into price.

Eric Jesse: Thanks, Josh. So one follow up question for both of you. I'd be curious, your thoughts here, which is when you're talking about a natural disaster, a hurricane in Florida, from an insurance market perspective, is that a Florida problem or are insurance companies spreading the risk? Are they going to increase premiums to me here in New Jersey because they have to pay out claims in Florida? How's the insurance market addressing that?

Brad Barron: I would say it's a systemic issue I think, and localized as well, right? Florida, you hear a lot about Florida because the insurer of last resort citizens down there they're arguing is vastly underfunded to the tune of a couple billion dollars. And well, why is that? Because more people are being driven to that last resort marketplace because the other carriers are pulling out from very high-risk areas like houses on the beach, that sort of stuff. And when you combine losses down in Florida, or anywhere really, and you start to look at insurers going in the red, what's their natural reaction? They're going to drive rate across their book, not just in the high-risk areas where it might go up double digits, that you might see single digits or even more percent increases everywhere as they try to balance and come to that equilibrium.

And I think it's a constant game of them... Not a game, but a constant effort of them trying to figure out what the right premium level is everywhere as things happen. They're reacting just like the rest of us to see what is the right rate that should be charged for these different policies and programs throughout the United States?

Josh Weisberg: And the proof is really in the pudding. When you talk about, like Brad said, single digit increases versus double-digit increases depending on sector, just for Q3 2023, 8.3% average increase against all major lines of business, meaning all major lines of insurance for the average insured. In the commercial property sector, that's 18.3%. So the sensitivities that Brad's outlining in terms of focus on one particular type of risk or one particular line of coverage such as commercial property, that's also making its way into all other lines of insurance.

Just something really interesting, when we're talking about wildfires which obviously pose a real risk to property insurers, one of the things that we saw with the Canadian wildfires this year was an increase in workers' compensation claims. Why? Because as the smoke conditions were coming into the United States from Canada, construction projects, folks that worked outdoors, they were inhaling smoke and they were filing workers' compensation claims. And so what Brad is talking about in terms of the unintended consequences or really the unexpected consequences of these kinds of catastrophic events, Eric, to your point, they're not just insulated to any one particular line of coverage or any one particular type of insured. Carriers need to think about this in terms of a holistic approach to how do I price my book of business so that I can remain somewhat profitable?

Eric Jesse: And actually, Josh, I just want to clarify this point that I think you touched on, because another question I had was when you have these property insurance claims from Florida, just to continue picking out Florida, I guess that's going to carry over to not just affect me here, my property insurance or someone's property insurance in New Jersey, but it might affect general liability lines of coverage as well. I think you touched on that. Is that right?

Josh Weisberg: Absolutely the case. When an insurance company looks at their entire book of business, and they don't just need to do this for themselves - keep in mind, insurance companies also place insurance on their own insurance policies. It's called reinsurance and I'm sure we'll talk about that in a few minutes - they need to take a look at their entire book of business, how each part fits into one another. And so that doesn't just take into account one particular type of policy. It takes into account all insureds, and so if there is a catastrophic loss in California related to wildfire, again, we talk a lot about wildfire but related to wildfire in California, that's going to impact the overall book, and so therefore, there will be costs that are going to be passed off to insureds in Massachusetts or New Jersey just based on the fact that you have a single insurance company writing in all those states.

Eric Jesse: One last question in today's episode, Brad and Josh. Josh, you mentioned reinsurance, and Brad, I'll kick it to you first. Why don't you tell our listeners how just the reinsurance market is also just impacting what can be done at the retail level, I'll say? And actually, if you could also just describe what reinsurance is for our listeners, I'd appreciate it.

Brad Barron: Yeah, sure. So Josh gave a quick preview of it. It's essentially insurance for insurance companies. So very few, if any insurance company actually hold the entire risk of their portfolio. So they're looking to spread their risk as well to other insurance companies and that's the process of reinsurance. So there's other insurance companies out there. They're going to say, "Okay, we will take 20% of your losses for 20% of your premiums, something like that, in this particular section of your book or across your entire program."

All sorts of different machinations in terms of how reinsurance can impact and be placed, but reinsurers as well, because they're just exposed as the frontline insurers are taking additionally a harder look at what are we covering? Who are we covering? What are all the underlying exposures for our clients, the insurance companies? Because they don't want to be too heavy in one place or another. Would you really want to put all your money into one stock, or do you want to spread it around a little bit? Insurers and reinsurers want to do that spreading aspect, really even it out as much as they can so if one place has a loss, it's not catastrophic for the company.

Eric Jesse: Got it. And Josh, anything to add on that?

Josh Weisberg: I would say, just to add to what Brad said, they're passing it off, but when you actually look at the dimensions of what this all means, I had a conversation with a fairly large insurance company a couple of weeks ago where they were telling us that the pricing on their reinsurance, and we're talking about pricing that's in the nine figures range, the pricing on their reinsurance had gone up by a multitude of doubling. The pricing doubled and the deductible for their reinsurance also doubled, and this was also a nine-figure increase. And so the challenge there is obviously you are retaining more risk because a deductible, just left on your homeowner's policy. That means the first $5 belong to you, the rest belongs to the insurance company. In this case, the first $250 million worth of losses belong to the insurance company and the balance belonged to the reinsurer, but at double the price, double the premium. That's really the real detail that's driving some of these problems.

Eric Jesse: Got it. Well, Brad, Josh, Heather, I want to thank you for this informative discussion. These are definitely issues that have, as we talked about, broad reaching implications on the insurance market and they're affecting businesses and individuals everywhere, whether they're subject to the insured events or not. But we're going to pause here for today, but we're going to keep the discussion going in the next episode of Don't Take No For an Answer. So, to our listeners, stay tuned, and to Brad, Josh and Heather, thank you.

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