MARKET CONDITIONS

When is hard actually hard?

Canadian brokers assess the current market in commercial lines, noting the contrast with what's happening in personal lines

By Sarah Cunningham-Scharf

Debate rages on as to whether the insurance industry is truly facing a hard market, or whether it is merely working its way through a pricing correction. Complicating the analysis is that the issues facing personal auto and property insurers are different than the ones facing the commercial lines market.

Seen at the view from 50,000 feet, both personal and commercial lines markets are experiencing tough times. Several major insurers have reported combined operating ratios (CORs) in excess of 100% over the past couple of years as they continue to struggle with climbing claims costs in both personal and commercial lines.

However, many in the industry insist that this market cycle isn't truly hard (yet). Pointing to the industry's overall COR of 97% in 2017 and 99% in 2018, they note that the P&C industry is still making a profit, albeit barely. Capacity is still available, suggesting that insurers are raising rates to correct for premium deficiencies during the past soft market cycle. In other words, this is simply a "market correction," not a true hard market, in which no profit is to be made for several years and no capacity is available.

Commercial brokers seem more likely to make the case against a hard market. They note the challenges in commercial lines are more nuanced than in the auto insurance market, for example, which is in need of regulatory reform across the country. In contrast, some commercial lines segments are more problematic than others, and many of the pricing issues are self-inflicted. And while auto and property started the move towards higher pricing awhile ago, a tough commercial market is just beginning. Marsh reported an 8% increase in commercial pricing across its global client base in 2019 Q3. That figure increased to 11% in 2019 Q4, the ninth straight quarterly increase and the largest since the brokerage started its survey in 2012.

Hard? Difficult? Correcting?

Industry analysts have tossed around many words to decribe current market conditions, each with different meanings. For veteran industry consultant Phil Cook, the proper terminology is important. He's not convinced it's a hard market, mainly because such a determination can't be made without the benefit of hindsight. "It's very difficult to say in the first year of a hard market that you're in a hard market, because it only really becomes apparent after one, two, or three years that this is the beginning of a hard market," the chairman of Omega Insurance Holdings Inc. said in January at the Insurance Institute of Canada's *Industry Trends & Predictions: 2020* breakfast in Toronto.

But for Kevin Neiles, chief marketing officer and president of Western Canada at Gallagher Canada, this is indeed a hard market. "If it's a correction, it's [correcting for] prob-

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ably 16 or 17 years of softening rates. When it's that significant, I would have to describe it more as a hard market."

Rates were soft [decreasing] for several years because, as Nathan Richmond, global placement leader at Marsh Canada, puts it: "Historically, there's been a lot of competition, and therefore a lot of pressure on organizations for top-line growth and market share." A second factor leading to soft rates was "a tremendous amount of capacity, especially from [Lloyd's of] London," Neiles says. "They came into the market, guns a-blazing, and became the largest commercial insurer in Canada." But when you combine insurer competition with "the size and number of Cat losses that we've had in Canada, and the increased cost of claims across the board," as Neiles observes, "you've got a significant imbalance between cash coming in the door and funneling out." Fast forward to 2018, he adds, and Lloyd's "started to exit as they realized that there was no profitability."

The patchwork correction

Today's hard market in commercial is "about the profitability challenge," Richmond says. "The fact that "a number of the major insurance companies around the globe since 2017 have been running an excess of 100% COR [is a] very different circumstance to previous hard markets." To get their CORs back on track, insurers are reducing their exposure to claims by "reducing their capacity to 20%, 30%, or 40% of what they previously offered, in some cases," Neiles reports. "We've seen five-fold increases in premiums, large increases in deductibles, and insurers pulling out altogether."

Another unique feature of today's market cycle is its patchwork nature. "In 2003, it was an [overall] 20% increase in the market. That's 'harder' than today, which is averaging out to between 6% and 10%," says John Chippindale, vice chairman of Hub Ontario and the brokerage's Canadian chief marketing officer. "But some [segments] are getting [between] 50% and 100% [hikes]," thanks to better, more specific data analyzing the risk profile of individual classes.

To get to a COR below 100%, "many of the insurers are 8% to 10% off-base," says Chippindale. "How do they make that up? Seventy percent of customers are going to get 6+% [increases] and 30% of [customers] are going to get 50+%."

The segments seeing the biggest premium hikes are those exposed to the biggest risks. So, while commercial segments like retail and most professional services lines are staying fairly level, commercial realty and commercial auto — especially policies covering third-party passengers, like taxis — are being hit hard, according to Chippindale. Lisa Giannone, managing partner of BFL Canada's Montreal office, says she's seeing price hikes "in more difficult sectors like forestry, long haul transportation, mining, the heavy industrial markets as well, manufacturing."

Neiles describes unique features of this market cycle that are unprecendented. "We're seeing scenarios where clients are unable to get cover," he says. "We've had to beg and plead to fill coverage. We've had to reduce coverage in certain areas to get the capacity that we need. I've been in the business for 33 years now. I have never seen it like this."

What's worse: Personal or commercial?

Ask a broker about the state of Canadian personal lines, and the discussion inevitably turns to the challenges insurers face in auto.

"Auto rates are filed with the government, and there's a lot of politics behind that," says Caroline Mills-White, senior vice president and national director of Aon personal lines arm Affinity. "They can only raise the rates so much. Once that's hard on our insurers, it becomes difficult on brokers."

Thankfully, some personal auto rates have been approved. In about 18 months, Chippendale says, those premiums will flow down to the insurer's bottom line.

Though both personal and commercial lines are in a crunch, insurers don't consider their fates to be intertwined. "Because the supply and demand on commercial is still pretty good, insurers don't have the luxury of overlaying personal lines and commercial lines," Chippindale says. "The pricing and the positioning is very independent."

Insurers have to navigate two very different paths to return to profitability in both commercial and personal lines. "The rabbit hole that personal lines has gone down is all but dictated by regulators," Neiles says. "It's partially outside of insurers' control. If you get enough rate, it can be fixed. It's a lot more smaller exposures."

But the commercial lines rabbit hole is worse, Neiles says, because it's "something the industry did to itself by chasing rates down." That said, he believes it will be easier for commercial insurers to return to profitability. "Through better underwriting, limiting their capacity, and getting higher rate, [commercial insurers] can get themselves out of the hole more quickly," Neiles says. "Personal lines insurers couldn't really do it unless you get out of [the space] all together."

Unfortunately, insurers won't return to profitability in commercial lines anytime soon, according to Giannone. "I think 2020 will still be a difficult market and then going into 2021, we'll see some relief, some capacity coming in." CU