Construction & Design Market Outlook

2023

LOCKTON

Table of contents

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The construction and design industry concluded 2022 with an increase of 8% in spending compared to the end of 2021. Residential, commercial, manufacturing and water supply infrastructure projects continued to see positive performance.

As we head into 2023, overall increased spending is projected in all three segments of the construction and design industries. However, target areas such as the single-family residential, power, office, retail and religious sectors are all expected to experience slowdowns in the year ahead. Construction starts are predicted to be flat as compared to 2022.

The forecast is promising notwithstanding continued concerns around inflation and a slowing economy. Despite these fears, construction performance indicators such as employment growth, national income and retail sales have all been rising. With this positive news, project spending in a majority of sectors is expected to increase.

For many contractors and designers, managing individual project profitability will remain a challenge. Retaining and attracting a growing workforce remains a priority for most organizations, with wages rising across all construction and design trades. The availability of building materials has improved, but pricing remains in flux.

2023 FORECAST SPENDING

Nonresidential building	
Amusement & recreation	+5%
Commercial	0%
Communication	+6%
Educational	+2%
Healthcare	+4%
Lodging	+4%
Manufacturing	+15%
Office	-2%
Public safety	+3%
Religious	-3%
Retail	-4%
Transportation	+8%

Nonbuilding construction	
Conservation & development	+12
Power	-5
Sewage & waste	+11
Street & highway	+11
Water supply	+12

Residential	
Multifamily residential	+25
Single-family residential	-12

Sources: FMI – 2022 North American Engineering and Construction Outlook 4th Qtr. Edition, Associated Builders & Contractors, and Dodge Construction Network

Insurance market outlook

Workers' compensation

Rates associated with workers' compensation are expected to remain somewhat stable in 2023. As we moved through 2022, rate changes averaged -1.3% for guaranteed cost policies and +2.3% for loss-sensitive programs.

For a majority of insurance carriers, this coverage line remains profitable. COVID-19-related claims have not materialized to the extent they were initially projected, even with the numerous presumption changes at a state level placing the compensability burden upon employers.

Due to labor shortages and inflationary pressures, reported payroll has grown. Potential increases in medical expenses will also be closely watched. These factors will cause both insurers and policyholders to continually evaluate overall workers' compensation conditions moving forward.

General liability

Amid a tempering market for general liability coverage as a whole through 2022, carrier partners would describe their rate needs in the high single digits on their specific books of business. Exposures in Florida, tough construction defect jurisdictions, residential (including multifamily) risks, and street and road contractors are among the segments that have driven additional need for rate.

Some carriers, however, sought to balance competing goals: on the one hand, staying profitable by pushing higher rates, and on the other, retaining accounts while also competing for new business. Largely, rate needs took a backseat to retention and growth goals in 2022. Actual renewal results for general liability were between 3% and 4%, excluding certain types or locations of businesses.

Looking forward to 2023, carriers remain under pressure to maintain favorable combined ratios despite higher interest rates, which should begin yielding higher investment returns in due time. That improvement will not impact this market for another 12 to 18 months at the earliest.

Court reopenings post-COVID-19 have also generated significant attention, with significant jury awards again making headlines. Unsurprisingly, verdicts continue to escalate, without any sign of tort reform on the horizon. The last positive movement on this front came in 2019, when Texas passed legislation to limit municipalities' use of contingent fee attorneys — a huge step in the right direction for many contractors in the state.

The carrier community unsuccessfully sought nearly 10% increases through 2022. For 2023, the message is expected to be the same — but the pressure to deliver higher rate results will be much more intense.

Automobile

Unlike those in the general liability market, commercial automobile underwriters were successful in delivering continued rate increases of 9% to 14% in 2022, depending on claims history, loss control adherence, fleet size and makeup, and jurisdiction. This will continue into 2023 and may actually worsen.

Claims are increasing in frequency while jury verdicts are growing in size; even “minor” accidents can now cost several thousand dollars. With all of the new technology in vehicles and the difficulty to find parts post-claim, the days of $500 fender benders are over.

While these issues are universal, regardless of location or scope, additional underwriting scrutiny should be expected in Florida and Texas due to higher-than-average claim and litigation trends in those states. From an insured’s perspective, a demonstrated focus on driver selection, fleet maintenance and fleet safety programs results in the best underwriting outcomes.

Favorable renewal results from a commercial automobile perspective are normally achieved in conjunction with a full primary casualty program (general liability, automobile and workers’ compensation) and viewed on an all-lines basis.

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Excess

In last year's report, Lockton projected a softening in the lead umbrella and excess market after the ruthless aggregate management and rate surges from late 2019 through the first half of 2021. That evaluation proved correct, as renewal rate increases moderated into the mid to high single digits. The results were even better when the lead umbrella carrier was supported by the primary casualty program, meaning that the same carrier underwrote all lines of coverage.

Even in the monoline, or unsupported, umbrella market, 2022 brought new capacity. Unfortunately, the hopes that the new capacity would increase the supply side of the equation and reduce costs even further did not materialize. Difficulty in the reinsurance market held prices relatively firm — still lower than in years past, but not offsetting some of the post-2019 rate results.

The same concerns described in the general liability and automobile sections exist for the excess market. As a result, all carrier and industry models still depict an underfunding in this market, yet rates continue to moderate. The 2023 umbrella and excess market is expected to look very similar to 2022.

When evaluating an umbrella renewal or alternative offering, consider the year-over-year changes in fleet size and makeup as well as the changes in field payroll or subcontracted costs. These are the exposures most heavily weighted in umbrella pricing.

Controlled insurance programs

Over the last year, controlled insurance programs (CIPs) have not been completely immune to the general increasing rate environment and shrinkflation associated with the shortening of available excess limit. Given the industry challenges associated with subcontractor unavailability, skilled labor shortages and still-volatile construction material cost escalations, project owners and contractors are still paying more for less overall coverage than they were receiving three to four years ago.

From a positive standpoint, the market has provided rate stabilization and selective broadening of coverages for most larger, high-profile commercial projects, further demonstrated by the return of selective deployment of “rolling” capacity in the primary and lead excess areas for best-in-class owners (OCIPs) and builders (CCIPs). This access to committed capacity for the best builders and owners signals the market has reached an inflection point: Insurers now recognize volume is likely to deteriorate due to broader macroeconomic factors, and that rate adequacy has reached a point where underwriters are willing to commit capacity over a longer period for certain types of risks.

ADDITIONAL KEY MARKET OBSERVATIONS INCLUDE:

- Primary liability rate increases are ranging from flat to +10% for most commercial projects.
- Excess rate increases are less extreme but are still in the flat to +15% range. Rates continue to be impacted by large losses from construction defects, wildfires, ESG concerns and pro-plaintiff labor laws.
- Larger excess towers involve several carriers that typically integrate quota share layers to maximize capacity and mitigate cost. As a result of large losses — in particular, for large Integrated GL/PL/PLL towers — there has been an increased focus on stacking of limits, aggregation of project-specific limits and capacity deployment for anti-climate change.
- CIP excess volatility remains for certain types of residential projects in specific geographies, and this has begun to spill further into the CIP general liability layers through rate increases and more stringent risk selection.
- Projects with difficult exposures, such as condominiums, stick frame apartments and hotels, continue to experience a disproportionate share of rate increases, for both primary and excess liability. This is further evidenced by very rare access to more than $10 million layers of capacity in the excess market.
- New York, Florida (specifically Dade County), Colorado and California continue to be difficult states, with reduced capacity driving cost.
- Broader coverage terms are becoming more readily available, depending on the type of project, contractors' safety program, QA/QC and loss experience.
- In response to COVID-19, a majority of carriers continue to add communicable disease exclusions.
- As budgets tighten due to higher lending costs and volatility in the materials and labor supply chains, policy extensions remain a concern. Many extensions are being offered only on a limited basis and for significant premiums. It is advisable to take a proactive approach when placing coverage as well as during the construction term.
- It is prudent to continue to monitor construction schedules during the course of a project, given the overall supply strain owners and builders are facing from a materials and labor perspective when executing project plans.
- Given the effect COVID-19 has had on the commercial office sector, we are seeing an uptick in conversion projects where an existing and often old commercial asset is converted to multifamily use or mixed-use. For these types of projects, it is extremely important to review the extended completed operations wording that triggers coverage for project completion, as these projects are often turned over on a phased (or by floor) basis.
- CIPs continue to afford coverage certainty to owners, contractors, lenders and other financial stakeholders by extending completed operations through a given state's statute of repose, particularly for residential projects when traditional contractors' insurance contains residential exclusions and the subcontractor's tenure in business tends to be shorter.

Residential

The residential construction market continues to be difficult due to adverse loss development, social inflation and increased loss frequency and severity. Current market conditions are exacerbated by claim activity in litigious states, particularly California, Arizona, Nevada, Florida and — more recently — Washington and Texas. Despite these ongoing issues, some new primary carriers are expected to enter this market in early 2023 to help fill capacity.

Excess capacity is still difficult to secure, specifically on accounts with heavy losses. Due to aggregate losses and historical pricing inadequacy, wrap-up pricing remains challenging. If there are delays in projects, pro forma wrap-up pricing should be updated monthly to keep more accurate figures.

The homebuilder warranty market continues to reduce in availability. Only one insurer now offers this coverage, with up to $20 million in limits and a large SIR based on the total number of homes. For non-warranty primary programs, large homebuilders are typically identifying a minimum $2 million to $5 million retention — significantly less than the warranty market — with around $60 million excess capacity.

Overall, 2022 was a challenging market, especially for homebuilders, due to less capacity being available, more expensive pricing and a push for higher retentions and attachments. Three insurers exited the space, and an additional two reduced capacity and sought higher attachment points. The pricing on excess layers continues to rise, forcing homebuilders to rethink what they are purchasing and what their total spend will be.

Contractor's professional liability

The contractor's professional liability market remains stable, with adequate available capacity, favorable terms and minimal rate increases on well-performing accounts. Policies continue to be reviewed and rated on an individual risk basis, with rate adjustments based on overall book performance having only a slight impact on individual results.

The liability impact of project delivery and allocation of risk is at the forefront of concerns for underwriters. Design-build contract delivery continues to create risk allocation challenges for contractors, leading to underwriters to seek to understand organizations' philosophies around project delivery methods, project bidding (lump sum vs. cost plus) and contract language.

The challenging architect and engineers (A&E) professional market has also impacted the risks contractors must assume within design-build contracts. How a company handles risk allocation can positively or negatively affect its insurance premium and/or individual coverage sublimits.

Many carriers report relatively stable claim frequency, but inflation and defense costs are driving an increase in the severity of claims. Additional underwriting scrutiny is being applied to heavy civil, alternative energy and large infrastructure projects/risks, areas where carriers are seeing an increase in claims activity.

Capacity for project-specific contractor's professional liability remains strong, but some carriers are positioning themselves to only offer project capacity to current clients. This could pose a challenge when large project-specific limits are needed.

Contractor's pollution liability (CPL)

As the construction industry experiences further growth, environmental placements continue to follow suit. Generally, the environmental insurance marketplace remains stable, and coverages available to contractors are flexible and competitive.

A CPL policy is intended to cover contractors for unintended contamination during the construction of a project. Pollution caused by contractors can seriously delay operations and impact construction profits.

Pricing for CPL remains competitive due to the number of carriers offering the coverage. Renewals are generally flat to +2%, depending on losses. Minimum premiums are as low as $1,500, with self-insured retentions as low as $5,000.

Coverage remains available on a practice- or project-specific basis. For the latter, inclusion of completed operations is standard, up to the statute of repose. Broad OCIP and CCIP structures are also widely obtainable. Insurers will differentiate themselves with valuable enhancements, such as extending coverage to contractors' owned or leased sites or locations used in connection with their projects.

Contractors in specific sectors or working on highly exposed project sites may be subject to greater underwriting scrutiny.

KEY AREAS OF FOCUS

- Carriers may reduce or tighten coverage for projects involving brownfield or formerly contaminated project sites. Exclusions applicable to construction material removal, dewatering and fill removal can be common.
- The emergence of new information surrounding chemicals of concern, such as poly- and perfluoroalkyl (PFAS), and nuclear verdicts involving them are contributing to the need for detailed information regarding a project site's historical use and potential environmental impacts. Without strong supporting data, full exclusions may apply.
- The upward trajectory of major losses due to mold and legionella continued in 2022. Insurers have consistently limited their coverage offerings for these pollutants to contractors working in industries such as healthcare, hospitality or residential construction.

Architects & engineers professional liability

Global market capacity for professional liability practice programs for large U.S.-based architectural and engineering firms continues to increase in the U.S., London and Europe. It is essential that large U.S. firms have a global perspective on the market to effect successful renewal programs.

Capacity for excess limits has increased at a faster pace than capacity and competition for primary program layers. Q3 and Q4 2022 renewals for large firms attracted more interest from U.S.-based underwriters than in previous years, but most programs continue to see a combination of U.S., London and European capacity as the path to success.

Negotiations on primary professional liability program layers continue to center on the proper balance of risk retention and risk transfer. Underwriters are focused on retention and premium projections based on actuarial loss predictions as they seek to improve combined loss ratios in the primary program layer.

Large engineering and architectural firms are seeking opportunities to use their balance sheets to optimize retained risk and manage their premium spend. The numbers are large, and mistakes in getting the right balance can be very costly to both underwriters and insureds. Solid analytics and models on both sides of the negotiation are essential.

Q3 and Q4 2022 renewals continued to see some headwinds on retentions and rate, particularly for the primary program layer. Underwriters were reluctant to yield any rate relief — even for firms that experienced significant growth in exposure basis — but some were willing to do so when an account had been profitable for them on a long-term basis. Single-digit rate increases were the norm for firms with profitable 10-year loss ratios.

While most large firm professional liability programs have already been “rightsized” for retention and rate based on 10-year loss ratios, underwriters will continue to seek rate gain as we enter the spring 2023 renewal period. Firms with good historical experience that have maintained that good experience into their 2023 renewals should find the market to be generally favorable, with competition available to manage toward successful renewals. Firms that continue to have adverse or deteriorating primary layer loss ratios will continue to face difficult renewal discussions.

KEYS TO EFFECTING A SUCCESSFUL 2023 PROFESSIONAL LIABILITY RENEWAL INCLUDE:

- Starting the renewal process early and working closely with brokers to have quality submissions in underwriters' hands 90 days before renewal.
- Building and maintaining global market relationships throughout the year to put firms in position to leverage global market capacity on both sides of the Atlantic.
- Being prepared to demonstrate strong claim and litigation management strategies for both open and future claims.
- Providing tangible evidence of the strength of a firm's practice and project risk management, including evidence of support at top leadership levels.
- Understanding key underwriter concerns about both the specific risk profile of a firm and current and evolving risks for the profession. This includes outlining a firm's approach to managing those risks. Current areas of concern include design-build exposures for designers, cyber and technology risk, wildfire exposure, residential projects, building envelope and cladding exposures, project staffing and quality control, supply chain risk, the increased cost and frequency of third-party bodily injury claims, and the inflated costs of litigation and claim severity.
- Highlighting a firm's profitable 10-year loss ratio — if, in fact, it has one — and identifying its causes. If a firm cannot do this, it should be diligent in explaining why the loss ratio will improve. The extra time and effort will yield a meaningful return.

After significant constriction in the project-specific professional liability market in 2022, driven primarily by the departure of the largest U.S. underwriter of PSPL, significant additional capacity entered the market in Q4 2022. While rates remain high for PSPL and retentions have increased significantly for large and high-risk projects, PSPL remains a viable risk transfer tool for large U.S. and foreign projects.

Contractor-led or design-build joint venture-led design-build projects continue to be major consumers of this insurance product. Underwriters are very diligent in understanding the percentage of design that will be completed prior to the contractor delivering a lump sum or guaranteed maximum price.

Progressive design-build with pricing committed after at least 60% design has been viewed favorably by PSPL underwriters. Material variation endorsements, insured versus insured language and audit provisions should continue to be at the top of insureds' review lists and should be shared with key project personnel.

Builder's risk

A number of insurers remain active in the builder's risk market, seeking to underwrite this risk. Premium rates are expected to increase on average of 5% to 6%. Contractor's master builder's risk (MBR) programs continue to be widely available and see an average 10%+ rate benefit as compared to stand-alone builder's risk policies.

The exact impact that Hurricane Ian had on individual project pricing remains unclear, but it is expected that the insurance market will limit coverage in catastrophe-prone areas. Deductibles for named storms could increase over the standard 3% to 5% of project values.

Pressure is building for wind/hail (non-hurricane) exposures on both capacity and deductibles, with some insurers also incorporating rate surcharges for projects in high-hazard (wind/hail) zones. The bulk of the rate increase consideration is on wind/solar and large roof-type projects. It appears, however, that underwriters are no longer evaluating a broad array of risks for a given property or project; instead, they are concentrating on evaluating the potential impacts from catastrophic events, with corresponding terms.

Market appetite for renewal energy projects is not growing at the same speed as general construction. An already limited marketplace for these types of risks is seeing constraints imposed by treaty reinsurers and stringent aggregate tracking, from a geographical concentration standpoint and a cumulation of course-of-construction and operational risk.

Policy extensions due to supply chain issues continue to be requested. These could be problematic for frame construction projects or projects that have had losses. Insurance buyers should plan ahead and provide markets with adequate notice for any extensions.

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U.S. domestic insurance market

Four-wall building/non-frame construction: Capacity remains available for these types of risks. For larger projects, a quota share structure with multiple carriers is often necessary to get full capacity. Rate increases are typically between 5% and 10%.

Frame construction projects: The insurance market for frame projects is limited to a few excess and surplus lines insurance carriers along with created program insurance facilities. In many cases, a “shared and layered” program approach is needed to obtain a full insurance limit capacity. Overall, rates are increasing 10% to 20%.

Primary and excess insurance carriers will require specific site security features. These include fencing, cameras by approved vendors, lighting and water mitigation.

Loss activity continues to drive the frame builder’s risk market, and recent large losses have reinforced many insurers’ reluctance to offer reasonable coverage to wood frame risks. This has resulted in most wood frame projects experiencing significantly higher premium rates with stricter coverage terms and conditions than for similar risks using noncombustible materials.

It is also common to see placements split across U.S. domestic markets and London/international markets because of the limited appetite among insurers.

London & international insurance markets

Trends in international insurance hubs have been similar to what the London marketplace had experienced over the last three years, with insurers in the U.S., Canada, Middle East and Australia all increasing rates and restricting cover for builder's risk exposures. These have largely been driven by poor performance in prior underwriting years, the increased cost of purchasing treaty reinsurance and the increased frequency of catastrophic events.

KEY HIGHLIGHTS & TRENDS

- There are now only a very limited number of insurers willing to provide cover for coal projects due to the environmental damage they cause. Most are now looking to focus their attention on the renewables sector.
- There are still a very limited number of insurers willing to provide cover for hydroelectric power plants following significant losses in this area.
- Although two new Lloyd's syndicates have entered the construction builder's risk market in London over the last 12 months, many international placement risks have continued to experience restricted coverage terms and conditions.

Erection all risk (EAR)

Typical examples: power, petrochemical, pipeline, refinery, LNG

Rate increase: 20% to 30%

OTHERS POINTS TO CONSIDER

- Natural catastrophe deductibles are being pushed upward, while NAT CAT policy limits are reducing.
- Defects in design London Engineering Group (LEG) wordings are being reviewed carefully with the reluctance to automatically provide LEG 3 (such as certain oil and gas projects).
- For power projects, underwriters focus more on manufacturers, as this will determine the types of defects clauses.
- Extended maintenance coverages are readily available, but guarantee maintenance extensions are more difficult to obtain.
- Delay in startup (DSU) deductibles have a minimum waiting period of 60 to 90 days.

Construction all risks (CAR)

Typical examples: tunnels, dams, roads, buildings, general infrastructure

Rate increase: 15% to 30%

OTHERS POINTS TO CONSIDER

- Deductibles are increasing, specifically for NAT CAT and water damage (for residential buildings).
- Insurers are increasingly focusing on clauses related to wet work and tunneling. Communicable disease exclusions are also being imposed by all insurers as the COVID-19 pandemic continues.
- DSU deductibles have a minimum waiting period of 45 to 60 days.
- Extended maintenance coverages are readily available, but guarantee maintenance extensions are more difficult to obtain.

Despite a difficult three to four years, it is important to point out that a significant amount of capacity remains. In the London market alone, $3 billion of capacity is available across all risk types and territories on a possible maximum loss (PML) basis. The key lead insurers are still actively involved in this sector. Their disciplined underwriting approach strengthens their credentials as markets that can withstand the cyclical nature of insurance and have the financial strength to underwrite risks through even the longest project period.

Subcontractor default insurance (SDI)

2022 was a year of significant and varied challenges for the construction industry. In addition to the lingering effects from COVID-19, the industry also faced labor shortages, supply chain disruptions, rising material costs, and increased storm frequency and intensity. Despite these difficulties, construction projects continued to forge ahead, creating both challenges and new opportunities.

As the construction industry continues to compete for materials and talent, business continuity and procurement strategies will be prime concerns for 2023. The SDI market is competitive, with seven insurers offering reasonable renewal terms and seeking to attract new buyers.

Underwriting discussions will continue to focus on the capacity of contractors' trade partners and suppliers as insurers seek to better understand subcontractors' workforces, including their size and skill level, amid even tighter project schedules. Impacts from supply chain disruptions and suppliers' substitution of materials to support projects moving forward have also elevated SDI underwriters' quality concerns. Insurers will continue to encourage organizations to implement mitigation strategies to inspect workmanship in an attempt to avoid potential claims.

One SDI insurer's claims data revealed that 2022 loss frequency and claims costs were within anticipated ranges, with no areas of unusual concern identified. Yet continual challenges and the uncertainties of COVID-19 have caused carriers to anticipate an increase in both the frequency and severity of defaults and related claims.

While general contractors' efforts to manage trade partner risk are effective, a review of certain categories of claims costs has identified areas for potential improvement. Average default claims dollars spent to address rework and unpaid lower trades is 36%, compared with 27% to finish a defaulted contractor's scope of work. Therefore, a focus on strong subcontractor management practices that emphasize a holistic approach to prequalification and trade partner selection is vital to the success of a project.

The SDI market is expected to remain strong in 2023, with capacity available for a majority of current and new buyers. Most carriers expect greater frequency of claim notifications and a rise in the cost to complete work associated with defaults.

Several insurers share a common concern about skill gaps for workers and overall labor shortages, which may hinder the ability of trade partners to fully commit to all projects in their backlogs. This could cause long turnaround times or incorrect/incomplete responses to project needs. Insufficient manpower, untrained or poorly trained workforces, procurement of wrong materials, turnover of supervisory and craft labor, quality issues and failure to maintain schedules are all signs of trade partner distress, any one of which could lead to a default.

As the construction industry anticipates project completion delays, increased construction costs and reduced profit margins, organizations should consider implementing the following risk mitigation practices in 2023.

10 KEY RISK MITIGATION PRACTICES

1. Engage in continual communication with key trade partners to understand backlogs and the timing of projects with other general contractors.
2. Consider early procurement for major equipment and material.
3. During the scope review process, identify major material suppliers and verify they have provided firm pricing commitments.
4. Monitor materials management processes to identify and confirm accuracy and quality prior to installation.
5. Focus on procurement and consider adding high-risk materials to project schedules to ensure they are on-site prior to installation.
6. Use or increase the use of technology to improve visibility and efficiency of project and field management.
7. Focus on bridging gaps between financial and operational prequalification to inform trade partner selection.
8. Evaluate the use of third-party prequalification tools that benchmark trade partners against their peers to indicate high and low performers.
9. Examine internal processes, procedures and controls regarding trade partner prequalification, selection and management throughout the duration of the project for stronger risk avoidance and risk mitigation practices.
10. Continue to focus on lien waivers and sworn statements to confirm timely payment of second-tier trades and material suppliers.

Marine cargo & stock throughput

Large claims continue to hit the marine market. These include the sinking of a large cargo vessel with an estimated $401 million in luxury automobiles and a massive fire at an Indiana fulfillment center, which was expected to exceed $175 million in a ground-up property loss. These and other significant losses have been impactful, but the consensus is that the U.S. and London marine markets remain strong and competitive.

Contractors and designers should still expect to see some degree of rate increases and underwriting scrutiny at renewal. However, any corrective measures taken would be primarily based on individual account performance and risk profile.

To ensure the best possible renewal outcomes, it is highly recommended that buyers initiate the renewal process early and provide comprehensive renewal submissions that focus on their business operations, exposures and risk management philosophies, which can significantly impact carrier negotiations and discussions.

DYNAMICS & KEY FACTORS IMPACTING CARGO & STOCK THROUGHPUT INSURANCE MARKETS

- Market stabilization and insurers' optimism are mainly driven by the three-year trend of higher rates and the streamlining of coverage. However, the implications of emerging risks continue to have a major impact on underwriting performance, which are being watched closely. These include above-average frequency and severity of CAT events and increased vessel catastrophes (such as container collapse, vessel fires, vessel groundings and general average contributions).
- Inflation has added yet another challenge for the industry and has the potential to drive a significant increase in values, claims and, ultimately, the cost to insure goods. In many cases, values have increased significantly on a year-over-year basis. To ease the impact of the increased values on renewal premium in 2022, some insurers offered flat or slightly reduced rates at renewal, depending on individual insureds' risk profiles.
- The reinsurance market was hit hard by Hurricane Ian, which caused around $65 billion in losses. As anticipated, U.S. catastrophe rates rose by some 40% at Jan. 1, 2023, reinsurance treaty renewals. Reinsurers also cut back their capacity, making it necessary for insurers to retain more catastrophe risk in 2023. Coupled with inflationary pressures, we should expect to see some of that cost being factored in 2023 renewals across all lines of insurance, including marine.
- Hurricane losses in 2022 more severely impacted the property insurance market than marine. Consequently, now would be a good time to consider or revisit a stock throughput program alternative, which has the potential to offer tailored inventory solutions with more favorable pricing and retention levels. The ability to remove inventory and stock values from property programs and their pricing may allow for more flexibility in marketing and placing property coverage.
- On renewals and new submissions, most U.S. insurers are continuing to exclude coverage for ALL perils of risk on shipments and storage exposures in and out of Russia, Ukraine, Belarus and territorial waters.
- While the supply chain and COVID-19-related issues that emerged in 2020 have not disappeared, some of the extensive delays at seaports and shortages of labor and truckers have eased. Shippers, however, are still challenged by higher freight costs and related expenses that are driving up insured values and claims, which ultimately impacts the cost of insurance.

UNDERWRITING CAPACITY

Insurers continue to be selective in deploying capacity and are increasingly focusing on reducing their exposure and becoming more profitable. However, organizations in general will continue to benefit from competition on new business and oversubscription on quota shared programs.

The increased capacity in London is helping to stabilize the cargo and STP insurance marketplace. As capacity has shrunk in some specialized segments, such as logistics, underwriters are redeploying capacity to less specialized lines, therefore requiring the use of excess placements to maintain limits.

COVERAGE

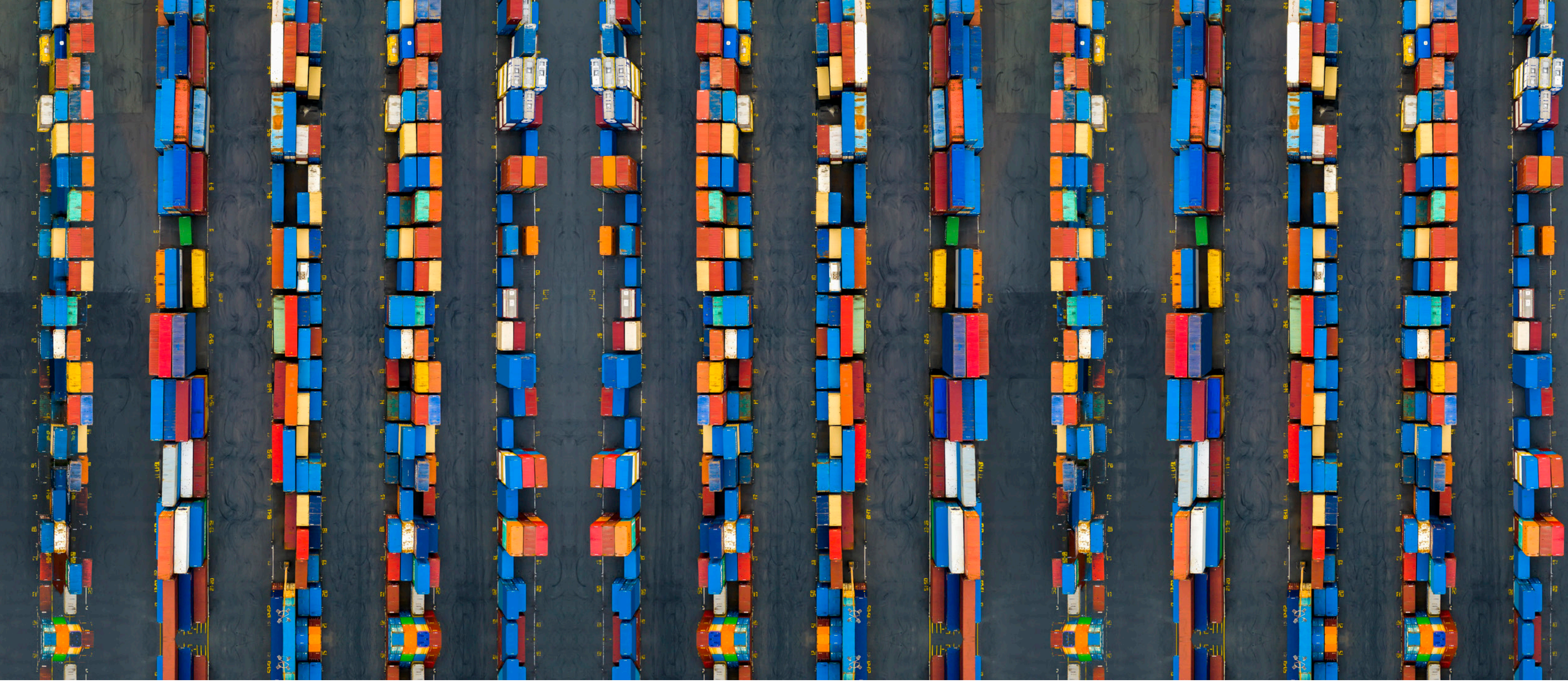
- Cyber and communicable disease exclusions are now standard on cargo and stock throughput policies.
  - Cyberattacks are a growing threat for the shipping industry, directly and indirectly impacting cargo exposures on vessels and at storage or processing facilities. Some degree of cyber exclusion buyback is available through a limited number of select markets.
- Policy wordings continue to come under scrutiny, resulting in narrower coverage through sublimits, aggregates, modified wording and exclusions.
- Heavily CAT-exposed exposures and difficult classes of business should expect continued strict underwriting guidelines, more detailed location information and expanded CAT definitions.
- Cargo insurers’ limited appetite for retail exposures continues to narrow. However, there is sufficient capacity available in the global marine marketplace to cover these exposures.

RENEWAL RATES

On average, cargo and stock throughput rates at renewal were flat to up 10% in 2022. In many cases, organizations with favorable risks profiles renewed with single-digit increases. Non-complex risks and well-performing cargo programs saw slight reductions in rate. Risks with complex risk profiles coupled with unfavorable loss histories experienced sharper increases and had higher retentions imposed. Looking forward to 2023, contractors and designers will likely see a similar trend, as insurers will push for additional rate to compensate for rising reinsurance costs.

Following the wider marine market, inland marine and logistics rate increases that were commonplace in 2021 and early 2022 have subsided and insurers are competing to some degree for low-loss accounts.

Remarketing to alternative insurers has been highly effective in achieving additional premium savings and maintaining broad coverage.



EXCESS STOCK PLACEMENTS IN LONDON

- Existing insurers and new entrants have brought total capacity in the London market to an estimated $1 billion+, helping to stabilize the cargo insurance market.
- Despite the difficulties caused by COVID-19 and other emerging risks, the London market is offering significant vertical limits.
- The London market is continuing to push for single-digit rate increases, on average, based on risk exposure and historical losses. Similar to the U.S. market, however, competition helps to ensure that renewal solutions remain appropriately priced.
- Pricing has shown the preferred excess attachment point is $20 million.

RECOVERIES & SUBROGATION

- Rising costs in the trucking market coupled with a shrinking pool of drivers translates to less capacity and fewer opportunities to demand adequate insurance limits from hired truckers.
- Shipper-designed carrier contracts help shift liability on negligence-based claims on losses both above and below retention levels.
- Recovery agents can help manage under-deductible claims on a no-cure, no-fee basis.

Although emerging risks bring new challenges, optimal insurance solutions are still available. The cargo and stock throughput markets are thriving, driven by competition and new capacity.

Cyber

From a cybersecurity standpoint, 2022 did not end as it began. At the beginning of the year, ransomware was the primary threat for most organizations, with ransoms heading to stratospheric levels as a result of increasingly frequent — and sophisticated — attacks. Russia then invaded Ukraine, which led to a reduction in ransomware attacks for a variety of reasons.

That seemingly created opportunities for threat actors to launch other forms of attacks. Fortunately, the design and construction industry has not been disproportionately victimized over the past year. Still, organizations should not be complacent about their cyber risk in the coming year.

Insider threats have grown significantly in 2022, with many observers pointing to the “great resignation” as a significant factor. Insider threats can take many forms, but they most frequently involve data theft by disgruntled and/or unscrupulous individuals who steal companies’ proprietary information for their own benefit or that of their new employers. Guarding against this threat requires robust file access and transfer monitoring.

Malware attacks have also increased over the past year. Malware is software designed to damage or impair access to electronic data or computer systems; it is similar to ransomware, but no ransom is demanded.
Importantly, attacks against Internet of Things (IoT) devices increased over 77%during the first half of 2022, according to cybersecurity firm SonicWall. Such attacks, if directed against IoT devices used in site monitoring, machine control and other critical areas, can have devastating consequences.

RANSOMWARE ATTACKS

OVER

85%

involve stealing data from a victim's computer system and threatening to publicly release it.

OVER

70%

target companies with 1,000 employees or fewer.

Source: Coveware

Although ransomware attacks are down, they remain a major threat. Threat actors have focused on increasing the pain of their attacks; today, over 85% of attacks involve stealing data from a victim's computer system and threatening to publicly release it if a ransom is not paid, according to ransomware consulting firm Coveware. Some threat actors have gone even further and contacted third parties whose information they found on a victim's system in the hope that they will persuade the victim to pay.

The privacy breaches resulting from ransomware attacks are significantly increasing potential losses to organizations and their insurers. These attacks are also producing significant business interruption losses, many of which have not yet been paid by cyber insurers.

While attacks against large companies garner most of the headlines, ransomware attacks are a problem primarily faced by small and midsized companies. Coveware research indicates that over 70% of attacks target companies with 1,000 employees or fewer. Basic cybersecurity controls — such as multifactor authentication, phishing training for employees and regular software patching programs — must be a top priority for every organization.

2023 will start on a hopeful note with respect to cyber insurance. At the start of 2022, premium increases of more than 100% were common. Today, it is occasionally possible to renew some cyber insurance programs without a rate increase; however, that is the exception rather than the rule. Increases are still likely but should seldom be higher than 20%. Every placement is unique, however, so individual results may differ.

One thing that is not changing is insurers' focus on ensuring that organizations have necessary cybersecurity controls in place. If an organization does not implement controls that cyber insurers view as essential, it may be very difficult to obtain cyber coverage.

Surety

The surety industry overall was again among the most profitable lines for property and casualty insurers in 2022, and it is expected to remain profitable in 2023. The industry loss ratio through September 2022 was 15.0%, essentially unchanged from the calendar year 2021 loss ratio of 15.2%. Although there is chatter in the construction surety industry about current economic issues, such as rising interest rates, inflation leading to a possible recession, material supply chain challenges and labor shortages, the surety industry continues to provide significant capacity and aggressive terms for best-in-class credit candidates.

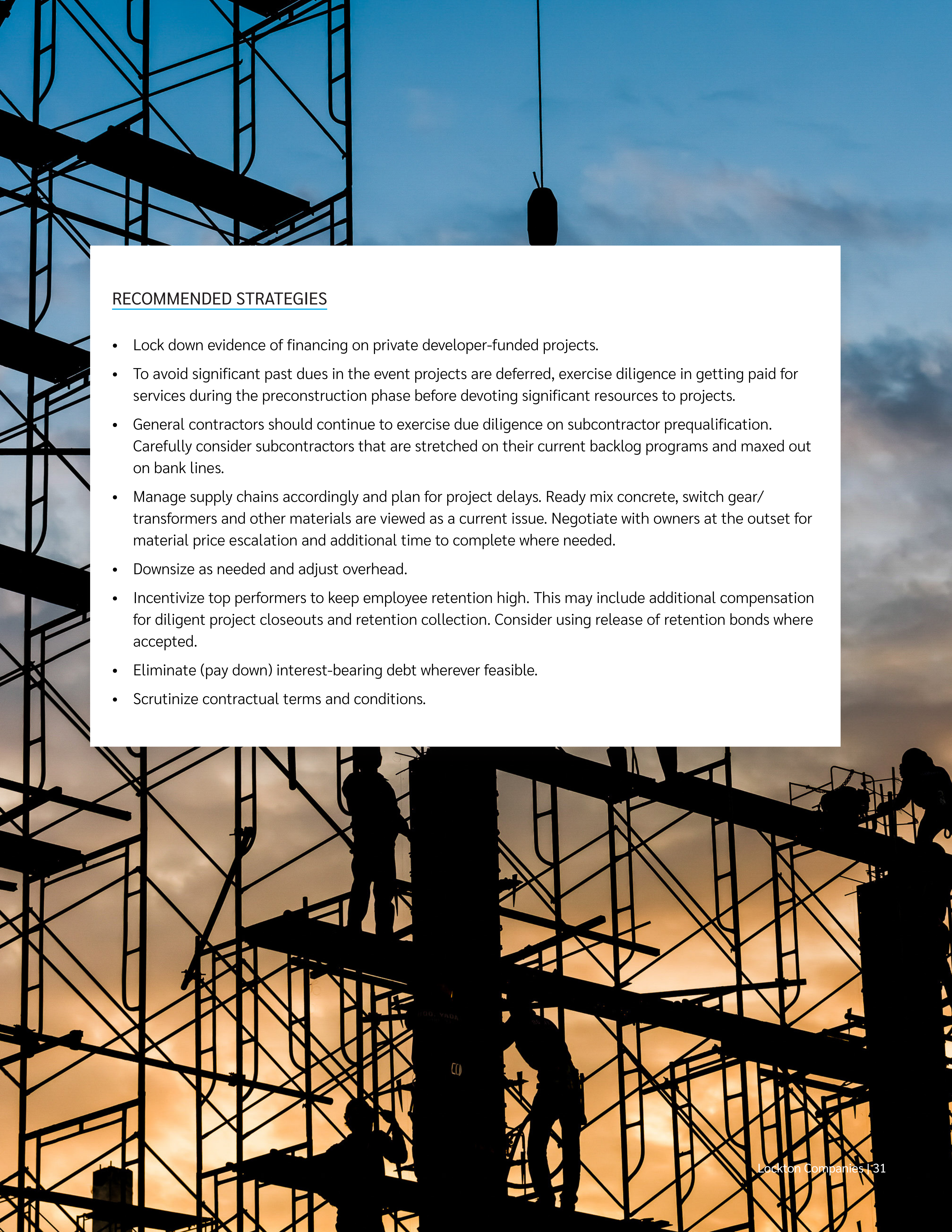
Additional surety market entrants will keep capacity plentiful, especially for small- to middle-market contractors. New insurance carrier entrants, such as Ascot, Amerisure, Munich Re and Applied Underwriters, have come online in 2022.

Overall, the construction industry — which was deemed an essential business during the early days of COVID-19 — fared well through the pandemic; current backlogs have largely returned to pre-pandemic levels. Forgiven PPP loans and ERC credits also contributed to the soft landing of many small- to middle-market contractors. In general, the construction surety industry (albeit a lagging indicator) continues to generate very positive returns and is anticipated to remain profitable in 2023.

Despite this positive news, construction sureties, along with large, sophisticated general contractors, are beginning to take a deeper underwriting dive into their portfolios of subcontractor exposure and private equity-owned construction companies. Rising rates are expected to affect both PE-owned businesses and those that rely heavily on debt financing, which has become more expensive. Interest-bearing debt facilities, such as revolving lines of credit, will also be affected during upcoming renewal periods.

Some industry sectors are beginning to see project deferrals, and some contractors are beginning to make necessary adjustments for a moderate future downturn. Although megaprojects such as semiconductor plants, lithium battery plants, airport/transportation projects, stadiums and arenas, and infrastructure projects continue to come online, it remains difficult for the construction industry to find skilled laborers and experienced project managers.

Sophisticated contractors with clear plans for addressing subcontractor labor restraints and supply chain bottlenecks — especially if they are in position to challenge contract language with owners related to project schedules and damages — are in the best position to demand surety cred.



RECOMMENDED STRATEGIES

- Lock down evidence of financing on private developer-funded projects.
- To avoid significant past dues in the event projects are deferred, exercise diligence in getting paid for services during the preconstruction phase before devoting significant resources to projects.
- General contractors should continue to exercise due diligence on subcontractor prequalification. Carefully consider subcontractors that are stretched on their current backlog programs and maxed out on bank lines.
- Manage supply chains accordingly and plan for project delays. Ready mix concrete, switch gear/ transformers and other materials are viewed as a current issue. Negotiate with owners at the outset for material price escalation and additional time to complete where needed.
- Downsize as needed and adjust overhead.
- Incentivize top performers to keep employee retention high. This may include additional compensation for diligent project closeouts and retention collection. Consider using release of retention bonds where accepted.
- Eliminate (pay down) interest-bearing debt wherever feasible.
- Scrutinize contractual terms and conditions.

UNCOMMONLY INDEPENDENT